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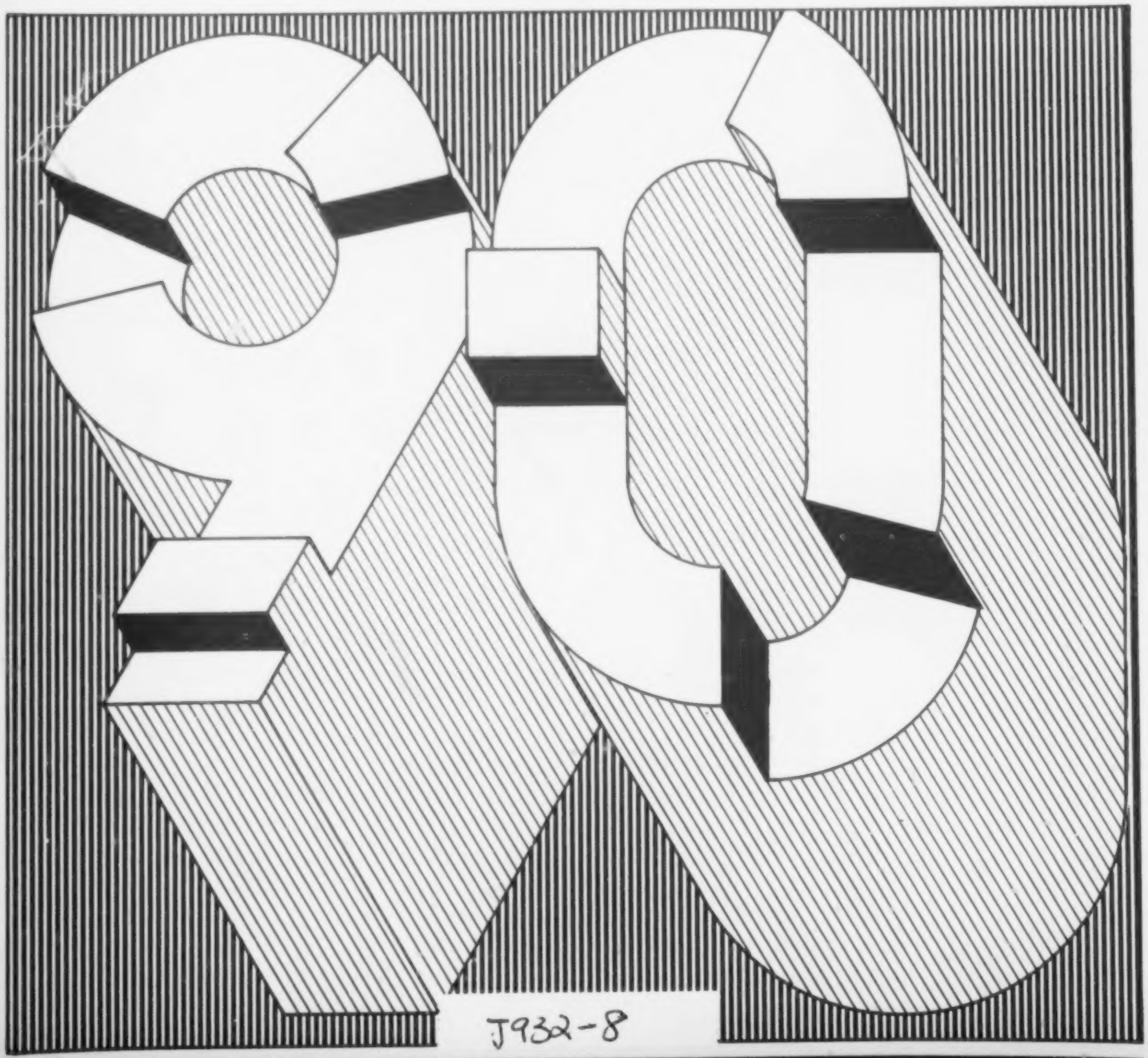
An Analysis of President Reagan's Budgetary Proposals for Fiscal Year 1990

Prepared at the Request of the
Senate Committee on Appropriations



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AN ANALYSIS OF PRESIDENT REAGAN'S BUDGETARY PROPOSALS FOR FISCAL YEAR 1990

The Congress of the United States
Congressional Budget Office

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NOTES

Unless otherwise indicated, all years referred to in this report are fiscal years.

Details in the text and tables of this report may not add to totals because of rounding.

The source of data concerning President Reagan's budget is the Office of Management and Budget. The source of other data, unless otherwise noted, is the Congressional Budget Office.

To facilitate comparison with the CBO baseline, allowances for the President's proposed civilian pay raises in 1990 through 1994 have been distributed among the individual budget functions, and the effects of the Administration's proposals for credit reform have been excluded.

The Balanced Budget and Emergency Deficit Control Act of 1985 is referred to in this volume more briefly as the Balanced Budget Act. The Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987 is referred to more briefly as the Reaffirmation Act.

PREFACE

This analysis of President Reagan's budget for fiscal year 1990 was prepared at the request of the Senate Committee on Appropriations. The report discusses the President's policy proposals in terms of changes from the Congressional Budget Office (CBO) baseline budget projections for 1990 through 1994. It provides estimates of the budgetary impact of the Administration's proposals using CBO's economic assumptions and technical estimating methods.

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Paul L. Houts and Sherry Snyder edited the report, and Nancy H. Brooks was responsible for production. The authors wish to thank Debra M. Blagburn, Linda Brockman, Cindy Cleveland, Marion Curry, Janice Johnson, Dorothy J. Kornegay, and Emma Tuerk for typing the many drafts. Kathryn Quattrone prepared the report for publication.

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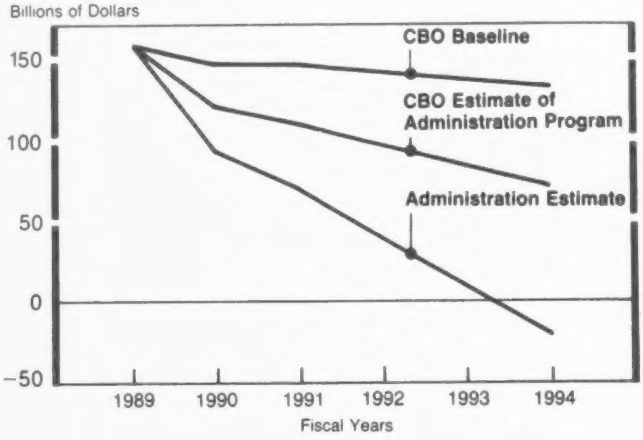
CHAPTER I

SUMMARY AND INTRODUCTION

The Congressional Budget Office (CBO) projects that, under current budgetary policies, the federal government deficit would decline only slightly--from $159 billion in 1989 to $146 billion in 1990 and 1991 and to $135 billion in 1993. The Reagan Administration proposes large reductions in nondefense spending, which would reduce the projected deficit to $120 billion in 1990, $108 billion in 1991, and $80 billion in 1993. But this improvement falls short of that required by the Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987, which calls for a deficit of $100 billion in 1990 and a balanced budget by 1993. The Reagan Administration was able to claim that its budget program met the act's targets by assuming much stronger economic growth and lower inflation and interest rates than CBO and most private forecasters, and by adopting more optimistic technical estimating assumptions. Figure I-1 compares the CBO and Administration budget projections.

Figure I-1.
Federal Deficit Projections



SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTE: The totals include Social Security, which is off-budget.

CBO AND ADMINISTRATION BUDGET ESTIMATES

CBO analyzes the Administration's budget in terms of changes from the CBO baseline, which projects the course of the budget on the assumption that current taxing and spending policies continue unchanged. CBO reestimates, or reprices, the Administration's budget using CBO's economic assumptions and technical estimating methods. The differences between the baseline projections and the CBO estimate of the budget measure the effect of the Administration's proposed policy changes.

Baseline Budget Projections

CBO's baseline budget projections follow the specifications contained in the Balanced Budget Act. The baseline generally assumes that tax and entitlement laws now on the statute books will continue. National defense and nondefense discretionary appropriations are assumed to be held constant in real terms. The current baseline projections update those published last month in CBO's annual report in order to reflect new information announced in the budget.

The baseline deficit rises from $155 billion in 1988 to $159 billion in 1989 before dropping to $146 billion in 1990 and 1991. The assumption of no real growth in discretionary spending, however, causes both total outlays and the deficit to decline in relation to the growing economy. The baseline deficit falls from 3.1 percent of gross national product (GNP) in 1989 to 2.7 percent in 1990 and 2.1 percent in 1993. Appendix A presents the baseline budget projections and explains the current revisions.

Projections of the Reagan Administration's Policies

CBO estimates that the 1990 budget deficit under the Reagan Administration's policies would be $120 billion in 1990--$27 billion more than the Administration's own estimate of $93 billion. About $10 billion of the $27 billion in reestimates is attributable to differing economic assumptions, and $17 billion stems from technical estimating differences. CBO's deficit estimates exceed the Administration's by $41 billion in 1991, $83 billion in 1993, and $98 billion in 1994. In these later years, most of the differences in estimates are economic (see Table I-1).

Economic Assumptions. The Reagan Administration's economic assumptions are much more optimistic than those of CBO, as discussed in Chapter II. Over the 1989 to 1994 period, the Administration projects average real growth that is a full percentage point higher than CBO's, inflation that averages one and a half percentage points lower, and long-term interest rates that are about two and a half percentage points lower. These differences in economic assumptions lead to substantially different budget projections.

The combination of lower real growth and higher inflation in CBO's assumptions produces nominal incomes and tax receipts close to the Administration's. CBO's higher inflation and higher interest rates, however, bring about much higher outlays than the Administration projects. In total, CBO's economic assumptions increase the estimated deficit by $10 billion in 1990, $32 billion in 1991, and $90 billion in 1994.

Technical Estimating Assumptions. CBO's technical reestimates of the Reagan budget increase the estimated 1990 deficit by $17 billion, comprising $21 billion in higher outlays offset by $4 billion in higher revenues. Over half the differences in outlays--$11 billion--stems from higher CBO estimates for the net outlays of the Federal Savings and Loan Insurance Corporation and Federal Deposit Insurance Corporation. CBO expects $5 billion less in proceeds in 1990 from the Administration's proposals to sell oil and gas leases in the Arctic National Wildlife Refuge, to accept competitive bids for use of the unassigned radio spectrum, and to sell the assets of the Southeastern Power Administration. CBO's estimates of spending for national defense and income security are also higher by more than $3 billion and almost $2 billion, respectively.

After 1990, technical estimating differences between CBO and the Administration are smaller, adding an average of $8 billion per year to CBO's deficit estimates. CBO's estimates of defense, deposit insurance, and income security outlays continue to exceed the Administration's, but CBO's revenue estimates are higher as well. CBO's tech-

TABLE I-1. CBO AND ADMINISTRATION ESTIMATES OF THE REAGAN ADMINISTRATION'S BUDGET PROGRAM
(By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993	1994
Estimates						
Revenues						
Administration	976	1,059	1,140	1,212	1,281	1,345
CBO	983	1,070	1,143	1,211	1,283	1,361
Outlays						
Administration	1,137	1,152	1,207	1,244	1,279	1,312
CBO	1,143	1,190	1,251	1,306	1,363	1,426
Deficit or Surplus						
Administration	-161	-93	-67	-32	2	33
CBO	-160	-120	-108	-94	-80	-65
Deficit Targets	-136	-100	-64	-28	0	a
Differences in Estimates						
Revenues						
Technical	-1	4	2	1	6	11
Economic	8	6	1	-2	-5	5
Total	7	11	3	-1	2	16
Outlays						
Technical	2	21	11	9	12	20
Economic	4	17	33	52	73	95
Total	6	38	44	61	84	114
Deficit or Surplus						
Technical	2	17	9	8	5	9
Economic	-4	10	32	54	77	90
Total	-2	27	41	62	83	98

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTE: The totals include Social Security, which is off-budget.

a. The Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987 established targets for 1988 through 1993.

nical reestimates of the Reagan Administration's budget are explained in more detail in Chapter IV.

THE REAGAN ADMINISTRATION'S BUDGET PROGRAM

CBO's baseline projections provide a benchmark against which the Administration's budget program can be measured. Because the baseline and the CBO estimate of the budget employ the same economic and technical estimating assumptions, differences between the two are solely the result of proposed policy changes. CBO estimates that the Reagan Administration's budget proposals would reduce the deficit by $26 billion in 1990, $38 billion in 1991, and $65 billion in 1994, as shown in Table I-2.

The Administration's revenue proposals would reduce the deficit by $1 billion in 1990 and by about $3 billion a year thereafter. About $2 billion per year would be raised through extending Medicare taxes and coverage to all employees of state and local governments. The Administration also proposes to maintain airport and airway taxes at 1989 rates and to increase Internal Revenue Service funding to enforce tax laws. Some of these gains in revenue would be offset by changes designed to encourage research and experimentation.

The Reagan Administration would increase defense outlays by an estimated $3 billion in 1990, $4 billion in 1991, and $8 billion in 1994, compared with the CBO baseline. Using the Administration's economic assumptions, the Reagan defense request represents a 2 percent average annual increase in real budget authority. Using CBO's higher inflation rates, however, the request contains only about 1 percent average annual real growth over the 1990-1994 period. In 1990, operation and maintenance, procurement, and research and development would all receive increases over the baseline. In 1991 and later, most of the increases in budget authority would be directed toward the procurement accounts.

If the Reagan Administration's proposals were adopted, nondefense discretionary outlays would be reduced by $5 billion in 1990, $10 billion in 1991, and $25 billion in 1994. Increases are requested to build the manned space station and the superconducting super collider, to replace expiring subsidized housing contracts with vouchers, to clean up toxic waste dumps, for contributions to international organizations, and for the operations of the Federal Aviation Administration, Coast Guard, Health Care Financing Administration, and Federal Prison System. Most other nondefense discretionary spending would be reduced below baseline levels. Direct loans by the Export-Import Bank, Farmers Home Administration, Small Business Administration, and Rural Electrification Administration would be virtually eliminated and partly replaced by guaranteed loans or vouchers. The Reagan Administration also proposes to terminate a long list of other programs, including energy conservation grants, postal subsidies for nonprofit organizations, the Economic Development Administration,

TABLE I-2. THE ADMINISTRATION'S DEFICIT REDUCTION PROGRAM AS ESTIMATED BY CBO
(By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994
CBO Baseline Deficit	146	146	140	135	130
Policy Changes:					
Revenues[a]	-1	-3	-3	-3	-2
National defense	3	4	4	5	8
Nondefense discretionary spending	-5	-10	-14	-19	-25
Entitlements and other mandatory spending	-17	-22	-25	-27	-29
Offsetting receipts	-1	-3	-1	-3	-3
Asset sales and prepayments	-4	-1	b	1	1
Net interest	-1	-3	-6	-10	-14
Total policy changes	-26	-38	-46	-55	-65
Deficit, President's Budget as Estimated by CBO	120	108	94	80	65

SOURCE: Congressional Budget Office.

NOTE: The totals include Social Security, which is off-budget.

a. Revenue increases are shown with a negative sign because they reduce the deficit.
b. Less than $0.5 billion.

TABLE I-3. CBO ESTIMATES OF THE REAGAN ADMINISTRATION'S BUDGET PROGRAM (By fiscal year)

	1989	1990	1991	1992	1993	1994
In Billions of Dollars						
Revenues						
Individual income	433	481	520	558	595	635
Corporate income	103	110	118	123	128	134
Social insurance	365	393	419	443	470	499
Other	82	86	87	88	90	93
Total	983	1,070	1,143	1,211	1,283	1,361
Outlays						
National defense	297	306	318	330	344	360
Nondefense discretionary spending	188	201	201	204	206	209
Entitlements and other mandatory spending	549	568	611	648	693	741
Net interest	169	181	190	192	194	194
Offsetting receipts	-60	-62	-67	-69	-75	-79
Additional asset sales	0	-4	-1	a	1	1
Total	1,143	1,190	1,251	1,306	1,363	1,426
Deficit or surplus						
On-budget	-216	-188	-187	-184	-183	-182
Off-budget	56	68	79	90	103	118
Total	-160	-120	-108	-94	-80	-65
As a Percentage of GNP						
Revenues						
Individual income	8.4	8.8	8.9	9.0	9.0	9.1
Corporate income	2.0	2.0	2.0	2.0	1.9	1.9
Social insurance	7.1	7.2	7.2	7.2	7.1	7.1
Other	1.6	1.6	1.5	1.4	1.4	1.3
Total	19.2	19.6	19.7	19.6	19.5	19.4
Outlays						
National defense	5.8	5.6	5.5	5.3	5.2	5.1
Nondefense discretionary spending	3.7	3.7	3.5	3.3	3.1	3.0
Entitlements and other mandatory spending	10.7	10.4	10.5	10.5	10.5	10.6
Net interest	3.3	3.3	3.3	3.1	3.0	2.8
Offsetting receipts	-1.2	-1.1	-1.2	-1.1	-1.1	-1.1
Additional asset sales	0	-0.1	a	a	a	a
Total	22.3	21.8	21.5	21.1	20.7	20.4
Deficit or surplus						
On-budget	-4.2	-3.4	-3.2	-3.0	-2.8	-2.6
Off-budget	1.1	1.2	1.4	1.5	1.6	1.7
Total	-3.1	-2.2	-1.9	-1.5	-1.2	-0.9

SOURCE: Congressional Budget Office.

a. Less than $0.5 billion or 0.05 percent of GNP.

the Appalachian Regional Commission, mass transit discretionary capital grants and operating subsidies, grants to Amtrak, community services block grants, capital contributions for the Perkins Loans, part of impact aid to school districts, training subsidies for health professionals, and federal funding for the Legal Services Corporation.

Entitlement spending would be reduced primarily through cuts in Medicare, federal retirement benefits, means-tested programs, and farm price supports. Medicare reimbursements to physicians, hospitals, and other health care suppliers would be lowered by $5 billion in 1990 and $10 billion in 1994. Health and retirement benefits for federal annuitants would be cut by $4 billion in 1990 and $8 billion in 1994. The budget proposes to lower federal spending for Medicaid and other means-tested programs by $4 billion in 1990 and $6 billion in 1994 by shifting these costs to state governments.

The budget proposals would increase offsetting receipts by $1 billion in 1990 and about $3 billion a year thereafter, according to CBO estimates. Premiums for Part B of Medicare would be increased to a level sufficient to pay for 25 percent of the program's costs. Fees would be charged for the right to produce or import chlorofluorocarbons, the use of certain bands of the radio spectrum, and the issuance of securities by government-sponsored enterprises. In addition, leases would be sold for oil and gas production in the Arctic National Wildlife Refuge.

The 1990 budget continues the Reagan Administration's policy of privatizing federal commercial activities by selling certain federal assets. Major proposals include the sale of rural and other housing loans, the prepayment of Rural Electrification Administration loans, and the sale of the Naval Petroleum Reserves, and the sale of the Southeastern and Alaska Power Administrations.

Table I-3 on page 7 shows CBO's estimates of the Reagan Administration's budget program by major tax source and spending category. The Administration's budget proposals are described in more detail in Chapter III.

CHAPTER II

COMPARISON OF ECONOMIC ASSUMPTIONS

The Reagan Administration's economic assumptions are more optimistic than those underlying the baseline projections of the Congressional Budget Office. For the 1989-1994 period, the Reagan Administration projects average real growth that is a full percentage point higher, inflation rates that average one and a half percentage points lower, and long-term interest rates that are some two and a half percentage points below those projected by CBO. These differences work to reduce the Administration's deficit projections below CBO's baseline estimates. This chapter briefly examines the differences between the Reagan Administration's and CBO's economic assumptions, and the budgetary implications of these differences.

THE SHORT-TERM OUTLOOK

The Reagan Administration's and CBO's economic forecasts through the end of next year involve differences in all of the major economic indicators:

- The Administration forecasts *higher real growth* than does CBO. On a fourth-quarter-to-fourth-quarter basis, the Administration's forecast of real GNP growth exceeds that of CBO by 0.6 percentage point in 1989, with the discrepancy doubling to 1.2 percentage points in 1990.

- The Administration forecasts *substantially lower inflation* than does CBO. The Administration forecasts a 1989 decline in consumer price inflation while CBO predicts a mild increase, with the Administration's inflation-rate forecast averaging 1.4 percentage points below CBO's for the 1989-1990 period.

- The Administration has a *substantially more sanguine view of interest rates.* The Administration forecasts short-term interest rates to average about 1.6 percentage points below CBO's forecast, with long-term rates some 1.4 percentage points lower on average.

For the most part, differences in the assumptions for inflation account for the different interest-rate forecasts; the Administration's and CBO's forecasts for real interest rates--interest rates adjusted for inflation--do not differ significantly. The Administration predicts real short-term rates that are only 0.2 to 0.3 percentage point less than CBO's, and real long-term rates that average close to those of CBO.

Sources of Forecast Differences

The CBO short-term forecast for 1989 and 1990 reflects a view that sustained strength in nonfarm output and growth in employment, together with only moderate growth in productivity, have pushed the economy close to its full-employment operating rate. Because similar conditions in the past have been accompanied by mounting inflationary pressures, CBO's forecast assumes that the Federal Reserve will maintain the monetary tightness of recent months to slow the economy's real rate of growth and reduce inflationary pressures.[1] As a result of monetary restraint, CBO projects that real growth will slow during 1989 to a range of 2 percent to 2½ percent. For the first half of 1989, short-term interest rates are projected to remain close to the levels that prevailed at the beginning of the year. Rates are expected to begin declining in the second half of 1989, however, as a slowing in economic growth reduces the need for monetary restraint, and deficit reductions are carried out to meet the Balanced Budget Reaffirmation Act's target for 1990.

CBO projects that temporary surges in energy prices and nonoil import prices will raise consumer price inflation to nearly 5 percent this year. Inflation is projected to remain at about the same level in

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[1] For a more detailed account of recent economic developments and the CBO economic outlook, see Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1990-1994* (January 1989), Chapter I.

1990 because of increases in wage growth caused by sustained tightness in labor markets.

The Administration, by contrast, forecasts stronger growth in output without any increase in inflation. Three key assumptions underlie this projection: that constraints on productive capacity will be avoided through strong advances in productivity; that temporary factors will reduce inflation rather than increase it, as in CBO's view; and that labor markets will not be as tight as CBO assumes. The Administration forecasts near-term growth rates for productivity that average 0.4 percentage point higher than those of CBO this year and next. The Administration anticipates some downward pressure on food prices as a result of the ending of the 1988 drought, while CBO expects food prices to increase about as much in 1989 as in 1988. The Administration also apparently expects consumer energy prices, which increased only 0.8 percent in 1988, to fall this year, while CBO expects an increase from the prices that prevailed at the end of 1988. In addition, the Administration takes the view that current unemployment rates are still well above the rate at which inflation may begin to rise.

Many analysts feel that persistently strong economic growth, such as that forecast by the Administration, would raise interest rates, in large part because of the prospect that Federal Reserve policy will be restrictive. If the Federal Reserve agreed with the Administration's forecast of inflation, it might not feel the need to keep monetary policy tight enough to restrain economic growth. The Chairman of the Federal Reserve has, however, repeatedly stated his view that growth rates exceeding 3 percent seriously increase the risk of inflation, and he has reiterated the determination of the Federal Reserve to reduce economic growth from last year's rate.

Comparison With Other Forecasts

Overall, the CBO forecast matches quite closely the consensus of private forecasters as reported by the *Blue Chip* survey (Table II-1 and Figure II-1).[2] The CBO forecast is designed to represent a middle

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[2] Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (January 10, 1989).

TABLE II-1. COMPARISON OF ADMINISTRATION, CBO, AND *BLUE CHIP* SHORT-RUN ECONOMIC FORECASTS

	Actual 1988	Forecast 1989	 1990
Fourth Quarter to Fourth Quarter (Percent change)			
Real GNP			
Administration	2.6	3.5	3.4
CBO	2.6	2.9	2.2
Blue Chip	2.8	2.3	1.9
Nominal GNP			
Administration	6.6	7.4	7.0
CBO	6.7	6.9	6.6
Blue Chip	6.9	6.7	6.3
Consumer Price Index[a]			
Administration	4.2	3.6	3.5
CBO	4.3	5.0	4.8
Blue Chip	4.4	4.8	4.7
Calendar Year Averages (Percent)			
Three-Month Treasury Bill Rate			
Administration	6.7	6.3	5.5
CBO	6.7	7.9	7.1
Blue Chip	6.7	7.8	7.3
Ten-Year Government Note Rate			
Administration	8.9	8.3	7.2
CBO	8.9	9.3	9.0
Blue Chip[b]	8.9	9.0	8.4
Civilian Unemployment Rate			
Administration[c]	5.4	5.2	5.1
CBO	5.5	5.5	5.5
Blue Chip	5.5	5.4	5.7

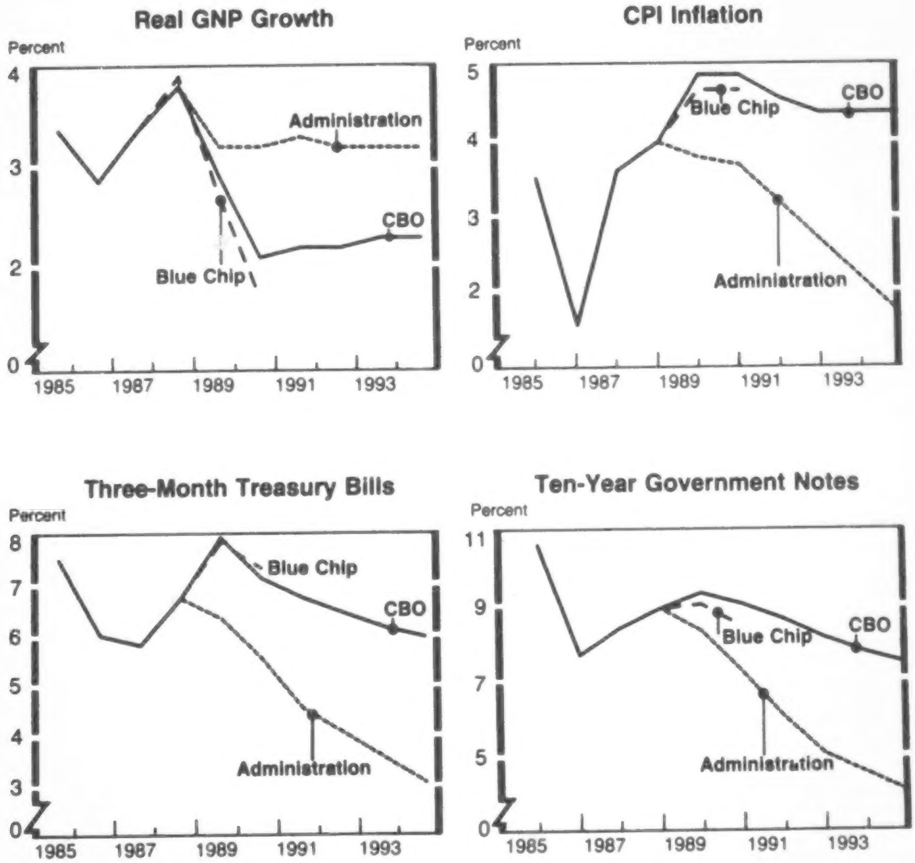
SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (January 10, 1989). The CBO forecast is based on data available through December 1988.

a. Consumer Price Index for urban wage earners and clerical workers.

b. *Blue Chip* does not project a ten-year note rate. The values shown here are based on the *Blue Chip* projection of the AAA bond rate, adjusted by CBO to reflect the estimated spread between AAA bonds and ten-year government notes.

c. The Administration's projection is for the total labor force, including armed forces residing in the United States, while the CBO and *Blue Chip* projections are for the civilian labor force excluding armed forces. In recent years, the unemployment rate for the former has tended to be 0.1 to 0.2 percentage point below the rate for the civilian labor force alone.

Figure II-1. Comparison of Administration, CBO, and *Blue Chip* Economic Assumptions



SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (January 10, 1989).

a. *Blue Chip* does not project a ten-year note rate. The values shown here are based on the *Blue Chip* projection of the AAA bond rate, adjusted by CBO to reflect the estimated spread between AAA bonds and ten-year government notes.

path, balancing the possibilities of both more favorable and more unfavorable outcomes. In contrast, the Administration's forecast reflects a highly favorable outcome, in which several things have to go right and nothing goes seriously wrong. The Administration's forecast lies at the optimistic end of the range of current forecasts for the key variables--real growth, inflation, and interest rates (see Figure II-2).

A number of private forecasters hold that the possibility of a recession is quite high. Most of these forecasters predict that at some time this year or next, credit market conditions will tighten significantly, foreshadowing a recession.

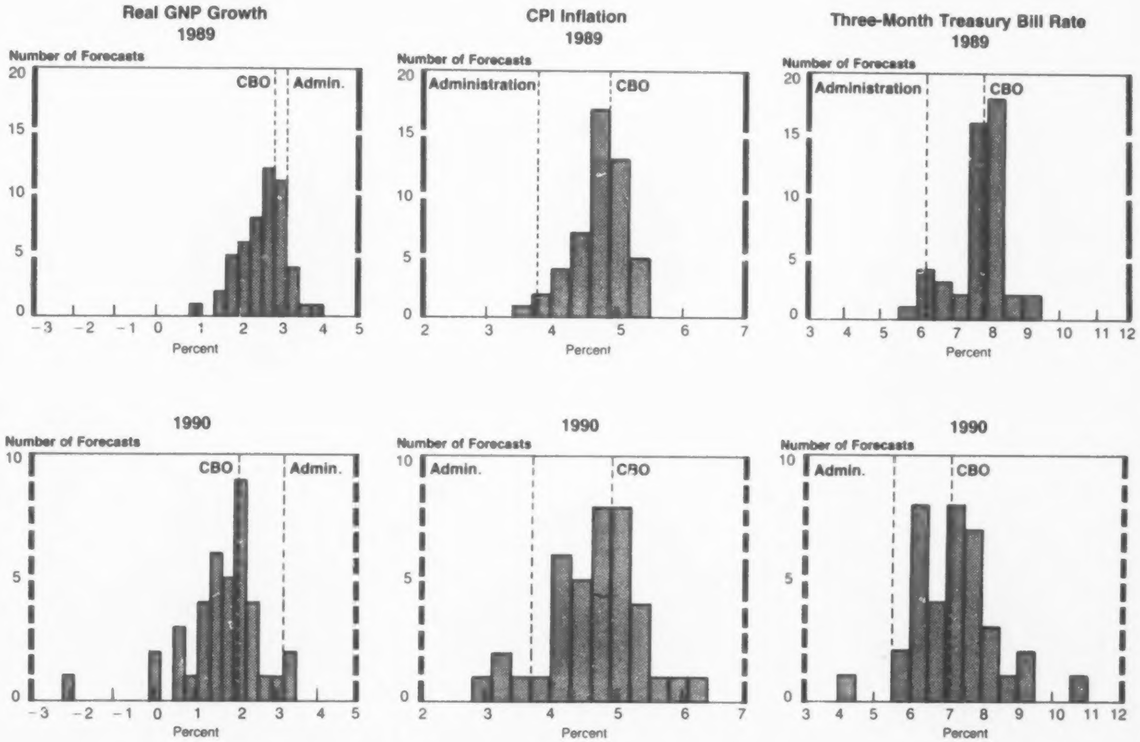
A key uncertainty in the forecast for the near term is whether the Federal Reserve will be able to keep domestic inflation under control and, at the same time, avoid a recession. Even under the best of circumstances, the central bank may not be able to slow the economy gradually. Slower growth in monetary aggregates and rising interest rates may not affect real growth significantly until credit markets reach a point at which a sharp downturn in economic activity is triggered. The economy may, therefore, continue to grow rapidly in spite of monetary tightening, thus provoking higher inflation, further tightening, a rapid increase in interest rates, and eventually a recession. This kind of scenario, often known as a "hard landing," underlies many private forecasts.

The CBO believes that a smoother slowing in growth over the near term is more likely than that implied by a recession scenario. The possibility of a near-term recession, however, remains a significant risk to the CBO forecast.

MEDIUM-TERM PROJECTIONS

Neither CBO nor the Administration attempts to forecast developments in the economy beyond the end of 1990. In constructing their projections for the 1991-1994 period, both organizations rely instead on historical trends. CBO develops projections that reflect average recent economic performance and show no effects of recent or prospec-

Figure II-2. CBO, Administration, and the Range of the *Blue Chip* Forecasts for Calendar Years 1989 and 1990



SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (January 10, 1989).

NOTE: The heights of the bars represent the number of *Blue Chip* forecasts that lie within the range indicated by the width of the bars. Bar widths are: 0.3 percentage point for real GNP growth, 0.3 percentage point for CPI inflation, and 0.5 percentage point for the Treasury Bill rate. There are 51 *Blue Chip* forecasts for 1989 and 39 for 1990.

tive policy changes. On the other hand, the Administration's projections show how conditions might improve as a result of prospective policy.

Projection Methods

CBO's projections for the years from 1991 through 1994 are produced using a simple method that relies primarily on projected growth in productivity and in the labor force. Productivity is assumed to grow about as fast as it has since 1981. In addition, the projection method assumes that, on average, levels of employment and output in the mid-1990s will reflect historically average rates of unemployment and capacity utilization. Since these historical averages include both recessions and boom periods, the projections assume in effect that one relatively mild recession will occur sometime during the 1991-1994 period. Inflation rates are assumed to remain near present levels, and real (inflation-adjusted) interest rates are assumed to move to the average level observed since 1973.[3]

The Administration's projections are based on a similar accounting for the projected growth in the labor force and in productivity, but without an explicit allowance for the possibility of a recession in the 1990s. Projections for growth in productivity, inflation, and nominal interest rates show improvements reflecting the expected success of the Administration's policy initiatives. Projected growth in productivity is based not on recent experience, but on the significantly faster average growth in productivity observed over the entire post-World War II period (see Table II-2).

Comparison of the Administration's and CBO's Medium-Term Projections

CBO projects growth in output at an average annual rate of about 2¼ percent, while the Administration projects a rate of about 3¼ percent--

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[3] The method of projecting output is described in more detail in previous CBO reports. See Congressional Budget Office, *The Economic and Budget Outlook: An Update* (August 1987), Appendix B, and *The Economic and Budget Outlook: Fiscal Years 1990-1994* (January 1989), pp. 30-31.

TABLE II-2. COMPARISON OF ADMINISTRATION AND CBO ECONOMIC ASSUMPTIONS, 1989-1994 (By calendar year)

	Estimated	Forecast		Projected			
	1988	1989	1990	1991	1992	1993	1994
Nominal GNP (Billions of dollars)							
Administration	4,857	5,211	5,570	5,939	6,296	6,640	6,968
CBO	4,859	5,209	5,542	5,902	6,281	6,685	7,117
Real GNP (Percent change, year over year)							
Administration	3.8	3.2	3.2	3.3	3.2	3.2	3.2
CBO	3.8	2.9	2.1	2.2	2.2	2.3	2.3
Consumer Price Index[a] (Percent change, year over year)							
Administration	4.0	3.8	3.7	3.2	2.7	2.2	1.7
CBO	4.0	4.9	4.9	4.6	4.4	4.4	4.4
GNP Deflator (Percent change, year over year)							
Administration	3.4	3.9	3.6	3.2	2.7	2.2	1.7
CBO	3.4	4.2	4.2	4.2	4.1	4.1	4.1
Three-Month Treasury Bill Rate (Percent)							
Administration	6.7	6.3	5.5	4.5	4.0	3.5	3.0
CBO	6.7	7.9	7.1	6.7	6.4	6.1	5.9
Ten-Year Government Note Rate (Percent)							
Administration	8.9	8.3	7.2	6.0	5.0	4.5	4.0
CBO	8.9	9.3	9.0	8.6	8.1	7.7	7.4
Unemployment Rate[b]							
Administration	5.4	5.2	5.1	5.0	5.0	5.0	5.0
CBO	5.5	5.5	5.5	5.5	5.6	5.6	5.6
Tax Bases							
Wage and salary disbursements							
Administration	2,434	2,605	2,780	2,969	3,159	3,342	3,515
CBO	2,435	2,615	2,787	2,969	3,163	3,370	3,590
Other personal income[c]							
Administration	1,618	1,721	1,853	1,955	2,043	2,119	2,204
CBO	1,626	1,754	1,870	1,977	2,090	2,211	2,346
Corporate profits[d]							
Administration	301	351	396	442	475	498	522
CBO	299	328	351	378	390	401	424

SOURCES: Congressional Budget Office; Office of Management and Budget.

[a] Consumer Price Index for urban wage and clerical workers.

[b] The Administration's projection is for the total labor force, including armed forces residing in the United States, while the CBO projection is for the civilian labor force excluding armed forces. In recent years, the unemployment rate for the former has tended to be 0.1 to 0.2 percentage point below the rate for the civilian labor force alone.

[c] *Other personal income* is personal income less wage and salary disbursements.

[d] Corporate profits reported are book, not economic, profits.

a substantial difference when continued over so long a period. While CBO assumes that inflation in the early 1990s will be close to the 4½ percent rate of underlying inflation that has persisted over the past five years, the Administration projects that inflation will continue to decline, reaching about 1¾ percent by 1994. As is the case in the short-term forecast, the difference between CBO's moderate decline in interest rates and the Administration's much sharper decline is attributable mostly to the different view of inflation.

Productivity Growth

As with the short-term forecast, the primary reason for the relatively optimistic Administration outlook is its projection of robust growth in productivity. This growth accounts for most of the difference between the Administration's and CBO's projections of output, and also helps explain the Administration's projection of a declining inflation rate.

CBO's projection of 1.3 percent productivity growth, on average, approximates the 1.4 percent growth in productivity achieved since mid-1981. While this projection of growth is substantially lower than the postwar average figure used by the Administration, it is nevertheless significantly higher than the 0.6 percent rate of productivity growth in the 1970s.[4] The Administration projects that growth in nonfarm business productivity will return to the average rate of about 2 percent observed over the 1948-1981 period (see Table II-3). Growth in productivity was remarkably high in the early postwar period, averaging about 2⅓ percent from 1948 to 1973. Since then, however, it has reached 2 percent or above only during periods when the economy has been recovering from a recession. (Strong growth in productivity is natural during such periods, since much idle capital and underemployed labor returns to work.)

Despite extensive research, economists have not been able to explain or predict historical changes in productivity growth. It is even harder to predict with confidence whether future growth will rise

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[4] The Administration also projects an unemployment rate of 5 percent for 1994 as compared with CBO's projected 5.6 percent. Other differences in assumptions regarding supply appear to be minor.

TABLE II-3. PRODUCTIVITY GROWTH IN NONFARM BUSINESS
(In percents)

	Average Annual Growth
Actual Growth	
1948:IV through 1981:III	1.9
1948:IV through 1973:IV	2.3
1973:IV through 1981:III	0.6
1981:III through 1988:III	1.4
Projected Growth	
1988:III through 1994:IV	
Administration	1.9
CBO	1.3

SOURCES: Congressional Budget Office; Office of Management and Budget; Department of Labor, Bureau of Labor Statistics.

above recent rates. Although several factors might increase productivity growth in the near future, other factors could lead to a slowing. The two major factors that could boost growth in productivity are: slower growth of the labor force (which means that more of investment goes to increasing output per worker and less simply to equipping more workers); and the increased experience and maturity of the baby-boom workers in the labor force. On the other hand, at least one other factor suggests that no speedup in productivity growth is likely. Growth in productivity has already benefited in the 1980s from a very sharp decline in the price of oil. Since further oil price declines of similar magnitude are not projected, this factor--taken by itself--would mean that growth in productivity will slow during the next few years.

Differences in Projections of the Tax Base

To identify differences between CBO and Administration projections of the tax base, it is useful to focus on forecasts of payments of wages, profits, and other incomes.

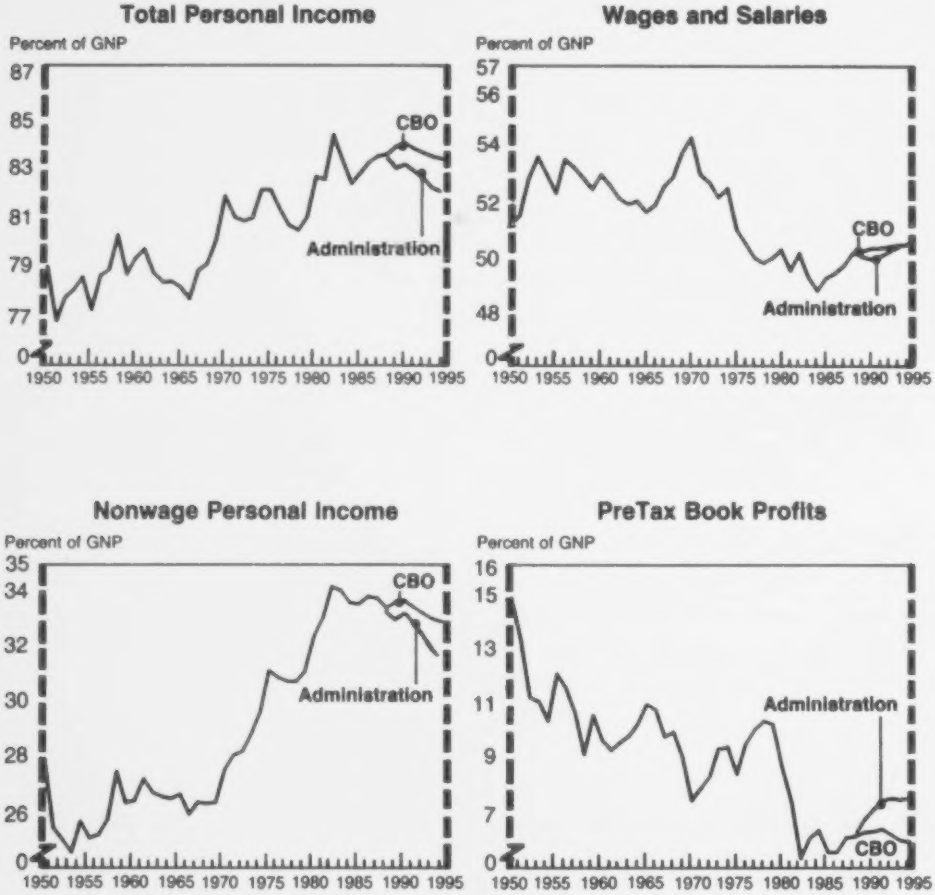
The largest differences are in the outlook for book profits and nonwage personal income. CBO expects book profits as a share of GNP to remain roughly constant, while nonwage personal income falls relative to GNP. The Administration, on the other hand, expects book profits to increase quite sharply in the next two years and then to remain at a relatively high level from 1991 through 1994 (see Figure II-3). It also expects the ratio of nonwage personal income to GNP to decline more rapidly than CBO's projected rate of decline. This path appears to result in part from an assumption that lower interest rates will reduce corporate net interest payments to households, thereby increasing taxable profits and reducing nonwage personal incomes. The CBO view differs from the Administration's for two reasons: CBO expects interest rates to be higher than those projected by the Administration, and it expects debt to continue to be a large share of total corporate financing, thus increasing corporate interest costs. The ratio of corporate profits to GNP has declined over most of the postwar period, in part because of past increases in corporate debt financing. The recent surge in leveraged buyouts is likely to contribute to a continuation of this long-run trend.

CBO's projections of wage and salary disbursements are slightly higher than the Administration's through most of the projection period, despite the fact that the Administration's projection of nominal GNP is significantly higher than CBO's. This discrepancy largely reflects different views regarding the prospective relationship between wage levels and productivity. CBO assumes that wage rates will roughly follow improvements in productivity, while the Administration projects that real wages will fall somewhat behind productivity in the near term, though they catch up later. As a result, CBO projects that wages and salaries will remain roughly constant as a share of GNP between 1989 and 1994, while the Administration forecasts an initial decline in the share.

BUDGETARY EFFECTS

The differences between CBO's economic assumptions and those of the Reagan Administration lead to substantially different budget estimates. The combination of lower real growth and higher inflation in

Figure II-3. Comparison of Administration and CBO Income Assumptions



Total Personal Income

Wages and Salaries

Nonwage Personal Income

PreTax Book Profits

SOURCES: Congressional Budget Office; Office of Management and Budget; Department of Commerce, Bureau of Economic Analysis.

CBO's assumptions produces nominal incomes and tax receipts close to the Administration's. CBO's higher inflation and higher interest rates, however, bring about much higher outlays and deficits over the next five years than the Administration projects. Substituting CBO's economic assumptions for the Administration's adds $10 billion to the estimated deficit for 1990 and increasing amounts in later years, as shown in Table II-4.

CBO's economic assumptions cause its revenue estimates to be slightly higher than those of the Administration in 1989 through 1991. Despite lower nominal GNP projections, CBO projects higher tax receipts in those years because it assumes that a larger share of GNP will be paid in the form of wages and salaries, the income source that is most heavily taxed. CBO also assumes higher capital gains

TABLE II-4. EFFECTS OF CBO ECONOMIC ASSUMPTIONS ON ESTIMATES OF THE REAGAN ADMINISTRATION'S BUDGET (By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993	1994
Revenues	8	6	1	-2	-5	5
Outlays						
Benefit programs	a	5	10	17	25	36
Net interest						
As a result of interest rates	4	11	21	30	37	43
Debt service	a	a	2	5	10	16
Subtotal, outlays	4	17	33	52	73	95
Deficit	-4	10	32	54	77	90

SOURCE: Congressional Budget Office.

NOTES: Each entry in the table represents the difference between an estimate based on CBO's economic assumptions and the corresponding projection reported in the Reagan Administration budget.

The totals include Social Security, which is off-budget.

a. Less than $0.5 billion.

realizations and higher Federal Reserve earnings. CBO's projection of the corporate income-tax base is below the Administration's in all years. This differential dominates the economic reestimates in 1992 and 1993. By 1994, however, higher wages and salaries and other personal income more than offset the shortfall in the corporate tax base.

CBO's projection of higher inflation leads to higher outlays for several benefit programs. CBO assumes Social Security cost-of-living adjustments (COLAs) of 4.9 percent in January 1990, 4.8 percent in 1991, and 4.4 percent in 1994. The Administration assumes COLAs of only 3.6 percent in 1990, 3.9 percent in 1991, and 2.1 percent in 1994. CBO's higher COLAs increase Social Security and other retirement outlays by amounts growing from $3 billion in 1990 to $27 billion by 1994. Higher costs of medical care cause CBO's projections for Medicare and Medicaid to exceed the Administration's by $1 billion in 1990 and $5 billion in 1994. Higher food prices increase Food Stamp outlays by about $1 billion per year.

CBO's interest-rate assumptions exceed those of the Reagan Administration by growing amounts each year. CBO assumes that the three-month Treasury bill rate will average 7.9 percent in calendar year 1989, 7.1 percent in 1990, and 5.9 percent in 1994. In contrast, the Reagan Administration assumes that the Treasury bill rate will decline to 6.3 percent in 1989, 5.5 percent in 1990, and 3.0 percent in 1994. CBO's higher rates increase net interest outlays by $11 billion in 1990, $21 billion in 1991, and $43 billion in 1994. In addition, economic reestimates of outlays and revenues increase debt service costs by $2 billion in 1991 and $16 billion in 1994.

CHAPTER III

THE REAGAN ADMINISTRATION'S BUDGET PROGRAM

The Congressional Budget Office estimates that the Reagan Administration's budget proposals would reduce the deficit by $26 billion in 1990, $38 billion in 1991, and $65 billion in 1994, compared with the CBO baseline (see Table I-2). Only small revenue increases are proposed, and defense spending would be increased. As a result, nondefense spending would bear the brunt of deficit reduction. About half of the savings would come from cuts in entitlement spending, a third from holding down nondefense discretionary appropriations, and most of the rest from lower debt service costs.

The Reagan Administration's proposals for revenues and for the major categories of spending are summarized here in terms of changes from CBO's baseline projections. This approach allows the focus to be on proposed policy changes, which otherwise can be obscured when making comparisons with the current fiscal year. This distinction is particularly important for revenues and entitlement spending, which increase each year as the result of economic growth, population changes, and other factors. This chapter summarizes the Reagan proposals for revenues and for the major categories of spending.

REVENUE PROPOSALS

The Congressional Budget Office estimates that President Reagan's revenue proposals would add $1.4 billion in revenue in 1990, $3.1 billion in 1991, and a total of $12.3 billion over the 1990-1994 period (see Table III-1). The President again proposes to extend permanently the research and experimentation tax credit and to adjust the rule for allocating these expenditures to foreign or domestic income. The bulk of the new revenues comes from collecting Medicare payroll taxes from the state and local government employees who now remain outside the

TABLE III-1. REAGAN ADMINISTRATION'S PROPOSALS--REVENUES (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	Cumulative Five-Year Changes
CBO Baseline	1,068.6	1,140.2	1,208.7	1,280.5	1,358.7	
Proposed Changes						
Establish permanent R&E credit	-0.4	-0.7	-1.0	-1.2	-1.4	-4.6
Change R&E allocation rules	-1.7	-0.7	-0.8	-0.9	-1.0	-5.1
IRS enforcement initiative	0.3	0.6	0.7	0.7	0.7	3.0
Require Medicare contributions of all state and local employees[a]	1.7	1.9	1.9	1.9	1.9	9.5
Repeal reduction in airport and airway taxes[b]	0.9	1.5	1.6	1.8	1.9	7.7
Reclassify, adjust, and extend customs user fee[b]	0.6	0.5	0.5	0.5	0.5	2.5
Other changes	c	d	-0.1	-0.3	-0.3	-0.7
Total	1.4	3.1	2.8	2.5	2.4	12.3
Reagan Administration's Budget as Estimated by CBO	1,070.1	1,143.2	1,211.5	1,283.0	1,361.1	

SOURCE: Congressional Budget Office.

NOTE: R&E = research and experimentation.

a. Net of reduced income tax revenues. Amount does not include increase in outlays of about $50 million over the 1990-1994 period.

b. Net of income and payroll tax effects.

c. Revenue increase of less than $50 million.

d. Revenue decrease of less than $50 million.

system, repealing the automatic rate reduction for the Airport and Airway Trust Fund tax, and hiring new Internal Revenue Service staff to speed up and increase the collection of taxes owed.

The CBO estimate that the proposals would raise $12.3 billion in revenues through 1994 is $3.4 billion lower than the Administration's estimate. Technical estimating assumptions reduce the revenue gain from the proposals by about $1 billion a year after 1990. Half of this technical difference is only apparent; it results solely from classification differences involving fees that the Administration classifies as revenues but CBO classifies as offsetting receipts in outlay accounts. Although not counted in the revenue total shown here, these proposals are included by CBO in the Nuclear Regulatory Commission and Customs Service outlay accounts.

Research and Experimentation Credit

The President proposes to make permanent the tax credit for research expenditures that is scheduled to expire at the end of 1989. The credit allows businesses to reduce their tax liability by 20 percent of the amount by which current research expenses exceed average expenditures over the preceding three years. The Technical and Miscellaneous Revenue Act of 1988, enacted at the end of the last session, extended the credit for one year, through 1989. Both CBO and the Administration estimate that making the credit permanent will reduce tax receipts by $0.4 billion in 1990 and by $4.6 billion from 1990 through 1994.

Research and Experimentation Allocation Rules

Spending on research and experimentation not only is eligible for the tax credit mentioned above but also can be deducted like other business expenses from current income. The President proposes to increase from 30 percent to 67 percent the minimum share of expenses undertaken in the United States that can be allocated to U.S. source income for tax purposes. The change in the allocation rule converts domestic source income into foreign source income. Because the foreign tax credit can be used only to offset the U.S. tax on foreign source income, the conversion would allow additional foreign tax credits to be used to reduce U.S. tax payments on worldwide income. Both CBO and the Administration estimate that the proposal, retroactive to 1988, will reduce tax receipts by $1.7 billion in 1990 and by $5.1 billion over the 1990-1994 period.

Internal Revenue Service Initiative

The only significant new proposal for raising revenues this year is the President's Internal Revenue Service (IRS) enforcement initiative. This initiative calls for additional examiners, revenue officers, collection agents, and clerical IRS employees. By performing tasks such as simple return audits, door-to-door collection of money owed, and cross-checking the IRS and Social Security records of taxpayers, these additional employees are expected to garner substantially more in tax collections than their cost to the IRS. The initiative would entail more than 1,700 new positions by the second year of implementation.

The President's budgets for 1987 and 1988 included different enforcement initiatives, although they also focused on increases in IRS staff. These initiatives were funded by the Congress, but the resulting net increase in revenues has not yet been determined. CBO and the Administration agree that the new initiative would increase revenues by $0.3 billion in 1990, $0.6 billion in 1991, and a total of $3.0 billion from 1990 through 1994 at a cost to the IRS of $0.4 billion over the five-year period.

Medicare Contributions from State and Local Government Employees

As in his 1988 and 1989 budgets, President Reagan proposes that one-quarter of state and local government employees--those hired before April 1, 1986--and their employers not now contributing to the Hospital Insurance (HI) portion of the Medicare system be required to do so. The majority of the employees not contributing are nonetheless eligible for Medicare benefits through their spouses' employment or other jobs held outside state and local government. CBO estimates that the proposal would increase payroll taxes by $1.7 billion in 1990 and $9.5 billion through 1994, the same cumulative increase estimated by the Administration. Benefits would be boosted by about $50 million over the same period, according to CBO estimates. The bulk of the increase in benefits flowing from the extension of coverage would occur in later years.

Repeal of Scheduled Reduction in Airport and Airway Tax Rates

The President proposes that airport and airway taxes be extended at current rates through 1994 to prevent a 50 percent reduction in these rates in 1990 as projected under current law. The Airport and Airway Safety and Capacity Expansion Act of 1987 extended aviation taxes at current rates through 1989 and specified that most of the rates would be halved on January 1, 1990, if obligations for airport grants-in-aid and appropriations for Federal Aviation Administration facilities, equipment, and research in 1988 and 1989 have been less than 85 percent of their authorized amounts. CBO and the Administration project that appropriated and obligated amounts will fall short of the threshold, triggering the reduction in rates. CBO estimates that extension of the taxes at current rates will increase airport and airway taxes by $7.7 billion over the 1990-1994 period, $0.2 billion below the Administration's estimate.

Adjustments to Customs User Fee

The President proposes for the second year to reclassify the ad valorem customs user fee as a revenue rather than an offset in the expenditure account. Enacted in the Omnibus Budget Reconciliation Act of 1986, the fee is scheduled to expire at the end of 1990. CBO estimates that this reclassification would move $0.7 billion in receipts to the revenue side of the budget in 1990 and a total of $0.8 billion by 1991. This accounting change would not affect the deficit.

The President also again proposes to extend the fee through 1994 and change its basis from the value of the imported good to the cost of customs processing. This adjustment is proposed as a requirement for compliance with the General Agreement on Tariffs and Trade. CBO estimates that this change and the reclassification together will increase customs revenues by $0.6 billion in 1990 and $0.5 billion each year from 1991 through 1994.

Both CBO and the Administration estimate that the proposed cost-based fee would generate less revenue than the present ad valorem fee. CBO estimates that the adjustments would increase the deficit by $0.1 billion in 1990. Despite the present fee's scheduled expiration date of 1990, the Administration assumes in its current services budget, which is equivalent to a baseline, that the present fee will be extended through 1994. The Administration therefore estimates that the change in the basis of the fee will increase the deficit by $0.2 billion to $0.3 billion per year over the 1990-1994 period.

Other Changes

The President proposes new fees for marine fishing licenses (for the third year) and a new fee for the Federal Emergency Management Agency's regulation of nuclear power plants (for the second year), along with several other new fees and adjustments to existing fees. The President also again proposes to modify oil and gas depletion rules and (for the seventh year) to increase the District of Columbia's contributions to the Civil Service Retirement System. In addition, the Administration proposes, as an administrative action, to change its treatment of coal mining reclamation fees. The current services budget assumes that these fees will be extended beyond their scheduled expiration in 1992. The Administration proposes to assume instead that the fees will expire on schedule. Taken together, these and other proposals with small revenue effects reduce revenues by $0.7 billion from 1990 through 1994.

NATIONAL DEFENSE

The Reagan Administration's defense budget for 1990 calls for defense appropriations totaling $315 billion, an increase of $16 billion over 1989. Outlays would total $306 billion in 1990, as estimated by CBO, for an increase of $10 billion over 1989 levels. Compared with the CBO baseline for 1990, which provides for zero real growth in defense appropriations, the budget would represent an increase of $6 billion in budget authority or an increase of 2 percent in real terms.

After 1990, defense budget authority in President Reagan's budget would grow by about 1 percent in real terms, based on CBO economic assumptions. The Administration claims that the budget provides for 2 percent real defense growth because of its lower projected inflation rate. CBO estimates that defense outlays would exceed the baseline by $3 billion in 1990, rising gradually to $8 billion in 1994.

Comparison with the CBO Baseline

Table III-2 shows how the Administration's request differs from the CBO baseline in the appropriation categories used by the Congress. Two accounts--operation and maintenance (O&M) and research, development, test, and evaluation (RDT&E)--receive the largest increases in 1990, about $1.9 billion each. By 1994, however, growth above the baseline is practically halted for O&M, and budget authority for RDT&E has fallen below the baseline.

Weapons procurement receives one of the larger increases in 1990, and the largest increases by far over the five-year period. The request for budget authority in the procurement account exceeds the baseline by $1.6 billion in 1990, and by $48 billion through 1994. The detail on the outyears is not available yet, but much of the increase probably stems from the planned procurement of the B-2 (or "stealth") bomber, the C-17 transport aircraft, and the V-22 tilt-rotor aircraft.

The military personnel accounts show a small increase in 1990. By 1994, however, they fall far below the baseline even though personnel levels change very little. Different assumptions about pay raises in the CBO baseline and in the Administration's budget are primarily responsible for this difference. Pay raises for military personnel, like pay raises for civilians, reflect the Administration's overall inflation assumptions, which are much lower by 1994 than CBO's (see Box III-1).

Outlays in the budget are not as far above the baseline as budget authority because of the composition of the increase in budget authority. Over the five years, the net change in budget authority is composed of increases concentrated in procurement--a collection of pro-

TABLE III-2. REAGAN ADMINISTRATION'S PROPOSALS--NATIONAL DEFENSE (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	Cumulative Five-Year Changes
Budget Authority						
CBO Baseline	309.2	322.4	335.9	349.6	364.0	
Proposed Changes						
Military personnel	0.3	-0.5	-1.6	-2.5	-3.5	-7.7
Operation and maintenance	1.9	1.7	-0.7	-1.0	0.5	2.5
Procurement	1.6	5.8	10.0	14.8	15.5	47.8
RDT&E	1.9	0.5	-0.1	-1.5	-2.1	-1.3
Atomic energy defense	0.6	0.6	0.7	0.6	0.5	2.9
Other defense	-0.4	0.3	1.9	1.4	1.7	4.9
Total Changes	6.0	8.4	10.2	11.8	12.6	49.0
Reagan Administration's 1990 Budget	315.2	330.8	346.1	361.4	376.6	
Outlays						
CBO Baseline	303.4	314.4	326.3	338.8	352.0	
Proposed Changes						
Military personnel	0.3	-0.5	-1.5	-2.4	-3.5	-7.6
Operation and maintenance	1.2	1.6	-0.3	-1.0	0.2	1.7
Procurement	0.3	1.5	4.0	7.5	10.8	24.0
RDT&E	1.0	0.9	0.2	-0.7	-1.6	-0.2
Atomic energy defense	0.4	0.5	0.7	0.6	0.5	2.7
Other defense	-0.1	a	0.7	1.3	1.5	3.4
Total Changes	3.0	4.0	3.8	5.2	8.0	24.0
Reagan Administration's Budget as Estimated by CBO	306.4	318.4	330.1	344.0	360.0	

SOURCE: Congressional Budget Office.

NOTE: RDT&E = research, development, test, and evaluation.

a. Less than $50 million.

BOX III-1
Comparison of CBO Defense Baseline with OMB Current Services Estimates

The CBO defense baseline and the Office of Management and Budget's (OMB's) current services projections both assume zero real growth in appropriations. The current services estimates for national defense exceed the CBO baseline in 1990, however, then fall below it from 1991 through 1994. The difference in 1990 stems from the different assumptions about military retirement accruals. In the outyears, the difference is caused by different assumptions about inflation.

The Department of Defense (DoD) makes payments to the Military Retirement Trust Fund to cover the benefit costs as they accrue for current active-duty and reserve personnel. The amount of the payment is estimated based on demographic characteristics of the military force and on very long-range economic assumptions. DoD actuaries have concluded that because of changes in demographics and the long-range economic outlook, the amount required for DoD's payment is nearly $3 billion less than was estimated a year ago. The Balanced Budget Act gives conflicting guidance on how the baseline should be prepared in light of such changes. The Administration has chosen an interpretation that raises the defense baseline and overstates the deficit (see Appendix A).

After 1990, the current services estimates fall below the CBO baseline, for two reasons. First, OMB assumes lower inflation rates throughout the period. The differences are greatest in the outyears and take the baseline $23 billion over current services in 1994. Second, CBO assumes that the Balanced Budget Act requires that pay absorption (that is, the shortfall in new funds for pay raises) from one year be added back in the following year. Pay absorption and a less important difference over the timing of pay raises for wage-board employees cause CBO's baseline to exceed current services by $0.2 billion in 1990 and $3.5 billion in 1994. The table below compares the estimates by CBO and OMB. Amounts shown are in billions of dollars of budget authority.

	1990	1991	1992	1993	1994
OMB Current Services	310.4	320.1	328.6	335.7	341.3
CBO Baseline	309.2	322.4	335.9	349.6	364.0
Difference	1.2	-2.3	-7.3	-13.9	-22.7
Factors Accounting for the Difference					
Inflation assumptions	-1.4	-4.5	-8.9	-15.0	-23.2
Accrual contributions	2.8	3.1	3.4	3.8	4.0
Pay calculations	-0.2	-0.9	-1.8	-2.7	-3.5

grams that take a relatively long time to complete and thus to generate outlays--and decreases in military pay accounts that spend out almost immediately.

Force Operations

The defense budget supports the daily operations of U.S. military forces around the world. The budget includes small net changes in force structure between 1989 and 1990, but military personnel strengths show a slight net increase.

Military Personnel. About half of the increases in average strength for the Army and Navy are offset by a reduction in the average strength for the Air Force. In 1991, when some force levels rebound to match or exceed their 1989 levels, a personnel increase for the Navy is totally offset by a reduction in the Air Force. The number of both full-time and part-time personnel assigned to reserve units rises in 1990 and 1991.

The 1987 Defense Authorization Act and subsequent amendments required reducing the number of officers by 6,400 compared with 1986 levels. The Reagan Administration's request represents greater reductions than anticipated (9,300 officers in 1990 and 9,500 officers in 1991)--in part because overall personnel strengths are lower. While officers represented about 14.3 percent of total strength at the end of 1986, they make up about 14.1 percent in the current request.

The Reagan Administration recommends a military pay raise of 3.6 percent in 1990, while the CBO baseline assumes a pay raise of 4.1 percent. The budget also seeks increases for the full-year costs of the 1989 pay raise and for general, as yet undefined, proposals to raise pay for health care professionals and to provide compensation for individuals traveling on official business.

Operation and Maintenance. The operation and maintenance accounts are also linked directly with force operations because they pay for maintenance, fuel, and other supplies critical to day-to-day missions. Although operating tempos change very little between 1989 and 1990, the O&M request shows an increase of about $1.9 billion above the baseline. A major issue for the last two years was whether the budget included enough funds to cover the costs of foreign currency fluctuations, but this does not seem to be an issue for the Administration's current request.

The $1.9 billion increase over the baseline is distributed among many force and support programs. Strategic programs--for example, Peacekeeper missiles and Trident submarines--increase by about $0.1 billion over the baseline in 1990. General-purpose forces, which include most conventional forces plus some nuclear weapons, account for the largest share of O&M. This category shows the largest increase over the baseline--about $1.0 billion. Central intelligence and communications rises $0.4 billion above the baseline. Among the support programs, central logistics is the largest, but grows little between 1989 and 1990. The program for training, medical, and other personnel support grows by about $0.3 billion over baseline levels.

The Administration's request includes $500 million in each year for the initial one-time costs of closing and realigning military installations as recommended by a bipartisan commission. Much of this amount will be expended for military construction at bases that will gain facilities as a result of reductions elsewhere. These costs eventually would be offset by savings from base closures, estimated by the commission to reach $900 million per year by 1994. In contrast, the budget, which was developed before specific recommendations were made by the commission, anticipates annual recurring savings to reach $2 billion by 1994.

Weapons Acquisition

The Reagan Administration's budget request gives the highest priority to weapons acquisition. Weapons acquisition proceeds first with a program of research and development and, second, with a program of annual procurement. Consequently, rapid growth enjoyed by the RDT&E accounts between 1980 and 1989 leads to planned increases in procurement through 1994.

Procurement. In addition to initial procurement of some very expensive weapons like the B-2 bomber, the budget for 1990 emphasizes two procurement strategies. The first strategy increases the use of multiyear procurement, which allows contracts to be written for several years rather than one year at a time. Contracts covering several years of production promote stability in weapons production and could result in efficiencies and budget savings to the government. According to Administration estimates, the 32 new programs planned for multiyear procurement will yield savings of $8.6 billion over the next eight years; CBO has no independent estimate of the possible savings. Multiyear procurement generally requires more budget authority up-front before net savings are realized.

The second procurement strategy emphasizes annual purchases at quantities that yield lower unit costs. However, many other factors, such as cumulative procurement to date and model changes, enter into budgeted unit costs. In general, the fruits of this strategy are more apparent in 1991 than in 1990. In 1990, increases in production rates are met with both increases and decreases in unit costs, but in 1991 higher production rates are associated with generally lower unit costs.

In 1990, total procurement in the budget exceeds the baseline by $1.6 billion. Aircraft procurement increases by $2.4 billion, including Navy and Air Force classified programs. The budget contains increases for the V-22, an aircraft to be used by all services for airborne assault, combat search and rescue, and special operations, and for the C-17, a new transport for inter- and intratheater operations. Other parts of the procurement budget with increases over the baseline include shipbuilding ($0.5 billion), spare and repair parts ($1.3 billion), communications and electronic equipment ($0.4 billion), and ballistic missiles ($0.1 billion).

Five categories of procurement fall below the baseline. Support and other equipment includes a wide variety of items from sonars to maintenance and testing equipment; the budget contains $16.5 billion for this category--a reduction of $1.2 billion from the baseline. Programs for tactical missiles, vehicles, ammunition, and other weapons show reductions from the baseline totaling $1.9 billion.

Research, Development, Test, and Evaluation. The largest program in the RDT&E account is the Strategic Defense Initiative (SDI). Nearly all of the $1.9 billion increase over the baseline in 1990 can be traced to SDI, which would grow from $3.6 billion and 10 percent of the 1989 RDT&E budget to $5.6 billion and 14 percent of the 1990 RDT&E budget. The SDI program commands an even greater share of the RDT&E budget in the outyears; in 1994, SDI would account for $10.7 billion, or 24 percent, of the RDT&E budget.

Atomic Energy Defense Activities

Recent events have focused national attention on the environmental safety and national security problems of the Department of Energy's (DOE's) nuclear weapons production complex. Various reports have pointed out a need to clean up environmental damage from past actions, prevent new damage, and invest in new capital for safer and more efficient operations.

Modernization is relatively urgent for reasons of national security and environmental safety. For example, a key component of nuclear weapons--an isotope of hydrogen known as tritium--decays quite rapidly and needs to be replenished. DOE does not now have the capability to produce tritium safely; funds for new reactors address this problem. Modernization costs are estimated to be $30 billion to $50 billion in constant 1990 dollars during the next two decades.

Cleaning up the environment could take until the middle of the next century; and, according to the Department of Energy, the defense establishment's share of environmental restoration could cost as much as $86 billion in constant 1990 dollars. The department is still determining the size of the problem and the relative urgency of each aspect. Even when the most pressing problems have been identified, DOE may not know the best solution or have the means to implement it; for example, the industrial infrastructure may not be prepared to support DOE's solution.

The Reagan Administration's request for all defense nuclear programs is $3 billion above the CBO baseline through 1994. Although the pace of modernization and environmental restoration will depend on many technological and economic variables, reports by the General Accounting Office and the Department of Energy indicate that the sums needed to correct these problems will be so large that the budget may have to be increased. Based on costs, priority, and schedule estimates from DOE reports, about $15 billion could be added to the budget ($18 billion to the CBO baseline) by 1994 to clean up and modernize the defense nuclear weapons complex (see Table III-3). This amount would represent a nominal increase of about 65 percent in 1994 over the total amount projected in the baseline for defense nuclear activities.

TABLE III-3. ALTERNATIVE PROJECTIONS FOR ATOMIC ENERGY DEFENSE ACTIVITIES (In billions of dollars)

	1990	1991	1992	1993	1994
CBO Baseline					
Budget Authority	8.4	8.8	9.2	9.5	9.9
Outlays	8.2	8.6	9.0	9.4	9.8
Reagan Administration's Budget as Estimated by CBO					
Budget Authority	9.0	9.4	9.9	10.1	10.4
Outlays	8.5	9.2	9.7	10.0	10.3
Alternative with Additional Funding for Nuclear Weapons Plants					
Budget Authority	9.4	10.8	12.6	14.5	16.4
Outlays	8.8	10.2	11.8	13.6	15.5
Increase Over CBO Baseline					
Reagan Administration's Budget as Estimated by CBO					
Budget Authority	0.6	0.6	0.7	0.6	0.5
Outlays	0.4	0.5	0.7	0.6	0.5
Alternative with Additional Funding for Nuclear Weapons Plants					
Budget Authority	1.0	2.0	3.4	5.0	6.5
Outlays	0.6	1.5	2.8	4.3	5.8

SOURCE: Compiled by the Congressional Budget Office based on data supplied by the Department of Energy.

NONDEFENSE DISCRETIONARY PROGRAMS

Nondefense discretionary spending consists of outlays for all programs, other than defense and entitlements, controlled through the appropriation process. This category encompasses a broad array of government activities, including foreign aid, space exploration, highway, transit, and education grants, housing subsidies, loans to farmers and small businesses, medical research, and the ongoing operations of all the nondefense agencies. About one-fifth of nondefense discretionary spending goes for pay and benefits for civilian agency employees, and about a third is for grants to state and local governments.

President Reagan's proposals would result in nondefense discretionary outlays of about $201 billion in 1990, an increase of 3 percent over the 1989 level but 2 percent, or $5 billion, below the CBO baseline. Over the next four years, outlays for these programs would increase an average of 1 percent per year, well below the average baseline increase of over 3 percent annually. Outlay savings in 1994 would be over $25 billion, representing an 11 percent cut in real spending in this category under CBO assumptions. Total spending reductions over the 1990-1994 period would be $73 billion relative to the CBO baseline (see Table III-4).

General Science, Space, and Technology

By far the largest increases proposed for nondefense discretionary programs are in space and science, with a 1990 appropriations request that is 20 percent above the 1989 level. Outlays in these areas would exceed the CBO baseline in 1990 by $1.2 billion, or 9 percent, and by $17.1 billion, or 24 percent, over the 1990-1994 period.

Three proposals would account for over two-thirds of this increase--development and construction of a manned space station, construction of the superconducting super collider (SSC), and significant additional funding for the basic research programs of the National Science Foundation (NSF). Spending for the space station would total $13 billion over the five years, $8.8 billion above the CBO baseline. (Before 1990, outlays for the space station will total about $1.3 billion.) The SSC would cost about $1.8 billion over the five years, $1.3

billion above the baseline. Outlays for NSF would be $2.3 billion, or 22 percent, over baseline levels during this period. Most of the remaining spending increases would be for space shuttle operations (partly to support construction of the space station) and space science activities.

TABLE III-4. REAGAN ADMINISTRATION'S PROPOSALS--NONDEFENSE DISCRETIONARY PROGRAMS
(By fiscal year, outlays in billions of dollars)

	1990	1991	1992	1993	1994	Cumulative Five-Year Changes
CBO Baseline	205.5	210.4	218.5	225.1	234.3	
Proposed Changes						
General Science, Space, and Technology	1.2	2.7	3.8	4.5	5.0	17.1
Commerce and Housing Credit	-1.1	-3.0	-3.5	-4.0	-4.4	-16.1
Natural Resources and Environment	-1.2	-1.6	-2.9	-3.9	-5.2	-14.6
Energy[a]	-0.4	-2.5	-3.3	-3.8	-4.5	-14.6
Transportation	-1.0	-1.8	-2.7	-3.7	-4.7	-14.0
Education, Training, Employment, and Social Services	-0.2	-1.1	-2.1	-3.1	-4.2	-10.8
Other	-2.1	-2.4	-3.3	-4.9	-7.4	-20.1
Total	-4.9	-9.8	-14.1	-18.9	-25.4	-73.1
Reagan Administration's Budget as Estimated by CBO[b]	200.7	200.6	204.3	206.2	208.8	

SOURCE: Congressional Budget Office.

a. Includes reclassification of uranium enrichment receipts.

b. Excludes the Administration's proposals for credit reform.

Commerce and Housing Credit

The Reagan Administration's budget targets this function for the sharpest cuts among discretionary programs. Spending over the 1990-1994 period would be reduced by more than half, resulting in savings of $1.1 billion in 1990 and $16.1 billion over the five years.

Most of the reductions would occur in the Farmers Home Administration's Rural Housing Insurance Fund (RHIF), which makes loans for the purchase or construction of low-income housing in rural areas. The budget would virtually eliminate all new RHIF activity, beginning in 1990, and would substitute a voucher program supporting about 60 percent fewer units. The net result would be a reduction in outlays of $1.2 billion in 1990 and $10.2 billion over the 1990-1994 period.

The Reagan budget also proposes to end loans for housing for the elderly or handicapped (which would be replaced by credit vouchers) and to discontinue the Small Business Administration's direct loan program and increase the fees for most of its guaranteed loans. The budget would also eliminate the appropriated subsidy for reduced postage rates for certain classes of mailers--primarily nonprofit organizations, libraries, and newspapers with a small circulation.

Natural Resources and Environment

The Reagan Administration's budget proposes spending levels for natural resources and environment programs that are below the CBO baseline in all years, with total outlay savings of $14.6 billion--or 14 percent--over the 1990-1994 period. Outlays in 1990 would be $1.2 billion below the baseline; this amount reflects an appropriation request that is 11 percent below the 1989 level.

With the exception of the Hazardous Substance Superfund, the budget includes outlay reductions in all areas of natural resources and environment spending. Outlays for the construction, operation, and maintenance of water projects by the Army Corps of Engineers and the Bureau of Reclamation would be about 8 percent below the baseline level in 1990. Forest Service outlays would be cut 14 percent below the baseline, spending on land and water conservation activities would be reduced by 5 percent, outlays for national parks and other recreational resources would be cut 10 percent, and spending by the National Oceanic and Atmospheric Administration would be held at 12 percent below the 1990 baseline level.

Appropriations for Environmental Protection Agency grants for the construction of wastewater treatment plants would be sharply reduced in 1990 and used mostly to capitalize state revolving funds. Appropriations for the Superfund, on the other hand, would increase by 23 percent over the 1989 level, with further increases proposed for subsequent years.

Energy

President Reagan's budget proposals for energy programs would result in spending levels that are $0.4 billion below the CBO baseline in 1990 and $7.7 billion, or 19 percent, below the baseline over the 1990-1994 period. (In addition, a change in the structure of the uranium enrichment program would reclassify $6.9 billion in enrichment receipts, but would have no net impact on the budget.) Nearly all of the spending changes in the energy area are attributable to changes in the Rural Electrification Administration and uranium enrichment programs, lower funding for energy research and development and energy conservation, and increases in Nuclear Regulatory Commission fees.

All direct loans made by the Rural Electrification Administration would be eliminated under the Reagan budget, reducing outlays by $3.9 billion over the 1990-1994 period. Spending for energy research and development would be reduced by $2.1 billion, or 13 percent, over the five years, and spending for energy conservation would be cut by 52 percent, saving an additional $1.3 billion over this period. The Reagan budget proposes raising Nuclear Regulatory Commission fees to pay for 100 percent of the commission's budget; this action would reduce outlays by $325 million in 1990, and by $1.7 billion over the 1990-1994 period. The uranium enrichment program would be transferred to a new government corporation; CBO projects the new corporation would increase spending by $0.3 billion in 1990 and by $1.3 billion through 1994.

Transportation

Total transportation spending under the Reagan Administration's budget would fall below the CBO baseline by $1 billion in 1990 and by $14 billion over the 1990-1994 period. Increased spending for some aviation and water transportation programs would be more than offset by reductions in ground transportation programs.

The Administration proposes federal-aid highway obligation ceilings of only $11.3 billion in each year, compared with the 1989 ceiling of $12.0 billion. Several currently exempt programs would be included under the ceiling. Together, these actions would result in outlays $0.2 billion below the baseline in 1990 and $8.4 billion below the baseline through 1994. A proposal to limit total budget authority for mass transit programs to $1.6 billion in 1990, compared with the baseline level of $3.4 billion, would reduce 1990 outlays by $532 million. In addition, the Administration would eliminate grants to Amtrak, reducing outlays by $550 million in 1990.

In other areas of the transportation budget, the Administration is asking for significant increases in funding. Requested appropriations for the Federal Aviation Administration's operations, facilities, and equipment--$5.9 billion for 1990--would exceed 1989 appropriations by $1.0 billion. The budget also requests increased appropriations for Coast Guard operating expenses and for acquisition, construction, and improvements.

Education, Training, Employment, and Social Services

The Reagan Administration's budget would reduce discretionary spending in these areas by $0.2 billion in 1990 and by $10.8 billion, or 8 percent, over the 1990-1994 period relative to the CBO baseline. Proposed changes in the budgetary treatment of the Work Incentive program and administrative costs for Foster Care somewhat offset the reductions in this function, but would not significantly affect aggregate spending.

Most of the savings in 1990 would stem from the elimination of three programs: community services block grants, capital contributions for the Perkins Loan program, and impact aid to school districts that provide services to children who either live on federal property or whose parents work on federal property, but not both. Elimination of the block grants would cut outlays by $2.0 billion over five years, and ending the other two programs would produce savings of $1.8 billion over this period.

The Reagan Administration's budget calls for increases at less than the rate of inflation for education programs targeted toward disadvantaged and handicapped children and toward low-income college students. Funding would be held at about the 1989 level for most of the other programs in this function, including job training grants, Head Start grants, library grants, Older American programs, and funding for the arts and humanities.

Other Nondefense Discretionary Programs

The remaining nondefense discretionary programs account for 1990 baseline outlays of $100 billion, slightly less than half of the total. President Reagan's proposals would reduce spending in these programs by $2.1 billion, or 2 percent, in 1990 and by $20 billion, or 4 percent, over the 1990-1994 period.

Agriculture. Reductions in agriculture programs would total $4.7 billion over five years, largely because farm ownership and operating loans made from the Agricultural Credit Insurance Fund would be cut by more than one-third from baseline levels in 1990, with further decreases in later years. Funding for agricultural research and services would be reduced by 10 percent in 1990 and frozen at about that level thereafter.

Health. The Reagan Administration's budget includes spending for health programs that is $4.3 billion below the baseline from 1990 through 1994, despite a substantial increase in spending for AIDS research and treatment activities. The request for AIDS funding is $0.3 billion, or 21 percent, above the CBO baseline for 1990, and outlays over the five-year period would be $1.4 billion above baseline levels. On the other hand, the Bureau of Health Professions would be eliminated, a service fee would be instituted for Food and Drug Administration product reviews, and spending for virtually all other discretionary health programs would be held below the baseline in all years.

Community and Regional Development. Spending for community and regional development programs would be below the baseline by $0.2 billion in 1990 and by $3.7 billion over the 1990-1994 period. Funding would be reduced for community development block grants and for lending programs of the Rural Development Insurance Fund and the Rural Telephone Bank. Other savings would result from terminating the Nehemiah housing opportunity program, Section 312 rehabilitation loans, Section 108 guaranteed loans, the Economic Development Administration, the Appalachian Regional Commission, Small Business Administration disaster loans, and the Tennessee Valley Authority's economic development programs.

Veterans Benefits and Services. Discretionary spending for veterans programs is largely for veterans' medical care, and under the Reagan budget it would be about $2.8 billion below the baseline over five years. The appropriation request for 1990 is about 2 percent above the 1989 level, and proposed increases in subsequent years average 4.6 percent per year.

Administration of Justice. In this area, outlays would be $2.1 billion below the baseline over the 1990-1994 period. The budget would terminate funding for the Legal Services Corporation and would sharply reduce funding for the Office of Justice Programs, eliminating both juvenile justice grants and drug grants. Funding for federal prisons would be 20 percent above the baseline over the five-year period.

Income Security. The budget includes reductions in many discretionary income security programs, including low-income energy assistance (30 percent below the baseline over five years); refugee assistance; supplemental feeding programs for women, infants, and children; and programs for the homeless. Excluding subsidized housing, spending for programs in this function would fall below the baseline by $0.6 billion in 1990 and by $5.0 billion over the 1990-1994 period. Unlike the CBO baseline, the President's budget includes funding during this period for renewal of about 960,000 expiring subsidy contracts. As a result, the reductions would be offset by increased spending for subsidized housing programs ($7.3 billion above the baseline over five years).

International Affairs. International affairs is one of the few areas targeted for real funding increases in 1990, though restrained growth for subsequent years results in net savings of $1.5 billion over five years relative to the baseline. The budget includes new programs for assistance to the Philippines and the International Monetary Fund, and proposes increased funding for contributions to international organizations and peacekeeping forces, multilateral development banks, and the State Department. Foreign military credits would be converted to grants. Direct loans made by the Export-Import Bank would be eliminated, and funding for various development and humanitarian assistance programs would be held below baseline levels.

Other Proposals. The budget generates additional savings by holding Social Security administrative expenses close to the proposed 1990 level in all years, and by assuming that funding for civilian agency pay increases by about 11 percent through 1994, compared with the baseline increase of 30 percent. (The difference in pay assumptions is reflected in each of the individual functions.) The budget also includes an allowance for outlay savings of $1.7 billion over five years from a proposed reduction in postal rates for government mail, which the Postal Service would have to offset through cost reductions and higher charges to other users. (Of this amount, $0.4 billion falls in the defense function.) In addition, agencies' payments for employees' health benefits would be reduced by $2.1 billion over the 1990-1994 period, reflecting a proposed change in the formula for calculating the government's share of health insurance premiums.

ENTITLEMENTS AND OTHER MANDATORY SPENDING

The Reagan Administration's budget for 1990 proposes reductions that would lower entitlement spending relative to CBO's baseline by $17.0 billion in 1990 and by $118.7 billion from 1990 through 1994 (see Table III-5). The request would lower the 1990 growth rate in entitlement spending from 6.7 percent to 3.5 percent. Over the five-year period, the average annual growth rate would fall from 7.0 percent to 6.2 percent.

TABLE III-5. REAGAN ADMINISTRATION'S PROPOSALS--
ENTITLEMENTS AND OTHER MANDATORY SPENDING
(By fiscal year, outlays in billions of dollars)

	1990	1991	1992	1993	1994	Cumulative Five-Year Changes
CBO Baseline	585.3	633.0	673.1	719.6	770.2	
Proposed Changes						
Medicare	-4.8	-6.4	-7.9	-9.0	-10.2	-38.2
Federal Retiree Benefits						
Civilian retirement	-2.7	-3.4	-3.7	-4.1	-4.5	-18.5
Military retirement	-0.8	-1.2	-1.5	-1.8	-2.2	-7.5
Annuitant's health benefits	-1.0	-1.2	-1.3	-1.5	-1.7	-6.6
Subtotal	-4.4	-5.8	-6.6	-7.4	-8.4	-32.7
Programs for Low-Income Individuals and Families						
Medicaid	-1.6	-2.3	-2.7	-2.9	-3.2	-12.7
Food Stamps, AFDC, Child Support, and Foster Care	-1.3	-1.2	-1.3	-1.4	-1.5	-6.7
Child Nutrition	-0.9	-1.1	-1.2	-1.3	-1.3	-5.8
Subtotal	-3.8	-4.6	-5.2	-5.6	-6.0	-25.2
Agriculture	-2.1	-2.2	-1.8	-1.5	-0.9	-8.5
Veterans' Loans	-1.1	-1.2	-1.2	-1.2	-1.2	-5.9
Other	-0.9	-1.5	-1.8	-1.8	-2.1	-8.1
Total	-17.0	-21.6	-24.6	-26.6	-28.8	-118.7
Reagan Administration's Budget as Estimated by CBO	568.3	611.4	648.5	693.0	741.4	

SOURCE: Congressional Budget Office.

The President's budget proposes the largest entitlement reductions in Medicare--the fastest growing entitlement program. Large dollar reductions are also proposed for federal retirement benefits, low-income programs, agriculture price support programs, and veterans' loans. As in the Reagan Administration's recent budgets, no reductions are proposed in cash benefit payments under Social Security.

Medicare

The Reagan Administration's proposals for Medicare would save an estimated $4.8 billion in 1990 and $38.2 billion over the five-year projection period. An additional $7.7 billion in savings would be achieved through a premium increase in Supplementary Medical Insurance, which is discussed under offsetting receipts. The Medicare legislative proposals would generally reduce payments to providers of medical services. Roughly 60 percent of the proposed reductions would affect hospital payments, about 35 percent would reduce physician payments, and the remaining 5 percent would come from reductions in payments to medical suppliers and from various other proposals.

The proposed reductions in hospital reimbursements would save $2.9 billion in 1990 and $22.4 billion from 1990 through 1994. All hospitals paid under the prospective payment system would receive a payment increase of 3.9 percent in 1990, rather than the 5.4 percent update assumed in the CBO baseline. In addition, the Reagan budget proposes to reimburse hospitals for only 75 percent of their costs for capital instead of the 100 percent required in 1990 under current law. Payments to teaching hospitals for the indirect costs associated with programs for interns and residents would be cut nearly in half, and some direct payments for overhead costs associated with medical education would be eliminated. Payments for certain outpatient hospital services would be cut by 5 percent in 1991. 8 percent in 1992, and 10 percent in 1993.

The Administration proposes to reduce payments to physicians by $1.5 billion in 1990 and $13.2 billion from 1990 through 1994--a much larger reduction than proposed in previous budgets. The Reagan budget would freeze the Medicare Economic Index (MEI), thereby freezing prevailing charges for services other than physician visits in 1990, and would limit the 1991 and 1992 increase in the MEI for these services to 1 percent. Other proposals would reduce payments to physicians for surgery, radiology, and anesthesiology, and would limit the maximum Medicare reimbursement to new physicians to an amount below the level that more experienced physicians would receive.

Federal Retiree Benefits

The Reagan Administration proposes savings of $4.4 billion in 1990 and a total of $32.7 billion through 1994, by reducing benefits for federal retirees and by shifting costs to the Postal Service and the District of Columbia.

Federal Civilian Retirement. The Administration's budget proposes cuts totaling $18.5 billion, or 8 percent, over the five-year period. The savings would come primarily from reducing cost-of-living adjustments (COLAs) to Civil Service and Foreign Service annuitants. The Administration proposes to eliminate the 1990 COLA and, beginning in 1991, to limit COLAs to the increase in the Consumer Price Index (CPI) minus one percentage point, with lesser reductions if the CPI rises by less than 3 percent. The Administration would also eliminate the lump-sum option for Civil Service retirees.

Based on an expected COLA of 4.9 percent for 1990, eliminating the increase would save $1.1 billion in 1990. Savings from the COLA changes would total $9.9 billion over the 1990-1994 period. If the COLA is eliminated in 1990, as it was in 1986 as a result of sequestration, real benefits of federal retirees will have fallen by 6.3 percent in four years.

In addition, the Reagan budget would eliminate the lump-sum payment option in the Civil Service system. Under current law, retirees may withdraw their contributions to the retirement system in a lump sum, with correspondingly lower annuitant payments in the future. Eliminating the lump-sum option would save an estimated $1.6 billion in 1990 and $8.6 billion through 1994.

Military Retirement. The Reagan budget also proposes eliminating the 1990 COLA and reducing future COLAs by one percentage point for military retirees. Estimated savings are $800 million in 1990 and $7.5 billion by 1994.

Government Payments for Annuitants' Health Benefits. The Reagan Administration's budget includes proposals that would reduce federal entitlement spending for annuitants' health benefits by $1.0 billion in 1990 and $6.6 billion from 1990 through 1994. The District of Columbia and the Postal Service would have to pay for health benefits of annuitants; the Postal Service already pays for those who retired after October 1, 1986. In addition, the Reagan Administration proposes to revise the method for calculating federal contributions to federal health benefits for both annuitants and current workers.

Programs for Low-Income Individuals and Families

The Reagan budget would lower federal spending in six programs designed primarily to assist low-income people and families--Medicaid, Food Stamps, Aid to Families with Dependent Children (AFDC), Child Support Enforcement, Foster Care, and Child Nutrition--by $3.8 billion in 1990 and by $25.2 billion from 1990 through 1994. Although no benefit reductions are proposed for low-income families, the indirect effects of these proposals might reduce or eliminate certain benefits for them.

Medicaid. The Administration's budget would reduce Medicaid spending relative to CBO's baseline by $1.6 billion in 1990 and $12.7 billion over the projection period. About 85 percent of these reductions would come from lowering the federal match rates to states. The share paid by the federal government for medical services currently varies from a low of 50 percent to a high of 80 percent. The Reagan request would reduce the federal match rate by as much as three percentage points in 1990, four percentage points in 1991, and four and a half percentage points thereafter, saving $1.1 billion in 1990 and $10 billion over the projection period. The Administration also would reduce the federal share of certain administrative costs, saving the federal government $0.3 billion in 1990 and $1.9 billion over the projection period. Unless states modify their Medicaid programs, these federal savings would result in increased costs for the states.

Food Stamps, AFDC, Child Support Enforcement, and Foster Care. The Reagan Administration's budget would reduce income support programs by $6.7 billion from 1990 through 1994. No reductions in benefits are proposed, but payments to state governments would be reduced. The Reagan budget proposes capping federal payments for administrative expenses in AFDC and Food Stamps, and reducing incentive payments in the Child Support Enforcement program. Federal payments for administrative expenses in the Foster Care program would no longer be an entitlement, thereby saving $3.7 billion over five years. Instead, those payments would be a discretionary grant funded at $2.4 billion through 1994. As for AFDC, the Administration proposes speeding up the collection of fiscal sanction payments from the states. Finally, the budget includes a $477 million reduction in outlays for Food Stamps in 1990. This reduction results from an accounting adjustment for food stamps that have not been redeemed over the last decade.

Child Nutrition. The President's budget would reduce spending in the Child Nutrition program by approximately 20 percent, or $5.8 billion over the projection period, by eliminating subsidies to children from families with incomes above 185 percent of the poverty level. Subsidies would be eliminated for about half the lunches served under the National School Lunch program, over two-thirds of the meals served in family day care homes participating in the Child Care Food program, and over 95 percent of the half-pints of milks served under the Special Milk program. In its estimate, CBO assumes that some schools losing subsidies for the higher-income category of students would stop participating in the program, whereas the Administration assumes that all schools would continue.

Agriculture

The agricultural policies proposed in the Reagan Administration's budget would reduce federal spending by $2.1 billion in 1990 and by $8.5 billion from 1990 through 1994. Because the Administration's policies are not fully specified in the budget, CBO's estimates are based on information in the budget supplemented by discussions with agency staff. The largest savings, $6.8 billion over five years, would come from cutting farm price supports. Target prices for wheat, feed grains, rice, and cotton would be reduced below baseline levels, saving $4.6 billion. Savings of $1.4 billion would come from cutting Targeted Export Assistance, cutting support prices or levying assessments for other commodities, and increasing administrative fees on export loan guarantees. In addition, the Reagan Administration proposes to pay 50 percent of all deficiency payments for the 1989 crop year in advance, instead of 40 percent, saving $850 million in 1990 but increasing 1989 costs by a similar amount.

The Reagan budget also proposes to repeal legislation enacted in 1988 that led the Administration to place all assistance to the Farm Credit System (FCS) on the budget. With this proposed change, the Administration would move most of the assistance back to an off-budget status, reducing federal outlays by $1.9 billion from 1990 through 1994.

Veterans' Loans

The President's budget contains two major proposals affecting veterans' home loans. The 1 percent origination fee charged to veterans obtaining guaranteed home loans is scheduled to expire on September 30, 1989. The budget proposes to make that fee permanent and raise it to 3.8 percent, which would increase collections by nearly $3 billion from 1990 through 1994. Further reductions in outlays are recommended through a continuation of structured sales of vendee loans. Under current law, the Department of Veterans Affairs is required, after fiscal year 1989, to return to selling loans with government guarantees against default. Proceeds from such recourse sales are considered a form of financing and, therefore, do not offset outlays. The structured loan sales have been defined by the Office of Management and Budget as nonrecourse sales, under which the proceeds would offset outlays. Since the CBO baseline reflects current law, the proposed continuation of structured sales would reduce outlays by approximately $2.8 billion over five years.

Other Entitlement and Mandatory Programs

The Reagan Administration proposes a number of other changes that would reduce spending by $0.9 billion in 1990 and by $8.1 billion from 1990 through 1994. The most significant proposals would:

- Eliminate both the cash and training benefits for Trade Adjustment Assistance (-$1.3 billion).

- Reduce lender yields and federal loan insurance for Guaranteed Student Loans and delay disbursement of certain Stafford Student Loans (-$1.8 billion).
- Reduce interim assistance to states for legalized aliens (-$0.6 billion).
- Change the repayment schedule for the power marketing administrations (-$1.5 billion).
- Decrease payments to states from mineral leasing, and reduce Forest Service payments (-$0.6 billion).
- Reduce nutrition assistance for Puerto Rico (-$1.0 billion).

OFFSETTING RECEIPTS

The federal government collects over $60 billion per year in user fees and other receipts that are counted as offsets to spending. The Reagan Administration's budget proposes several changes that would increase offsetting receipts by $0.9 billion in fiscal year 1990, and by more than $18 billion through 1994. (A change in the structure of the uranium enrichment program would reduce offsetting receipts by almost $7 billion, but would have no net effect on the budget.) The effects of the proposed changes are discussed below and are shown in Table III-6.

Medicare. A proposed increase in Medicare premiums would yield $0.2 billion in additional receipts in 1990, and $7.7 billion over the 1990-1994 period. The budget would extend a provision that requires that the Supplementary Medical Insurance premium be large enough to finance 25 percent of the program's costs.

Chlorofluorocarbon Production Rights. The budget proposes charging the market value for the rights to produce or import chlorofluorocarbons and related substances that deplete the ozone layer. Charging fees for these rights would result in $0.4 billion in receipts in 1990, and $3.9 billion in receipts over the 1990-1994 period.

Unassigned Spectrum Auction. President Reagan's budget proposes to auction the rights to certain Federal Communications Commission licenses for unassigned portions of the electromagnetic spectrum. CBO estimates that this proposal would yield $0.5 billion in receipts by 1992, whereas the Administration estimates auction receipts of about $3.4 billion.

TABLE III-6. REAGAN ADMINISTRATION'S PROPOSALS-- OFFSETTING RECEIPTS
(By fiscal year, outlays in billions of dollars)

	1990	1991	1992	1993	1994	Cumulative Five-Year Changes
CBO Baseline	-61.4	-64.2	-68.2	-71.8	-75.6	
Proposed Changes						
Medicare	-0.2	-0.7	-1.3	-2.2	-3.3	-7.7
Chlorofluorocarbons production rights	-0.4	-1.4	-0.6	-0.6	-1.0	-3.9
Unassigned spectrum auction	-0.2	-0.2	0	0	0	-0.5
Government enterprises	-0.1	-0.2	-0.6	-0.8	-1.0	-2.6
Arctic National Wildlife Refuge	0	-1.6	b	-1.0	b	-2.6
Power marketing reforms[a]	b	-0.4	-0.3	-0.4	-0.4	-1.5
Uranium enrichment	b	1.6	1.8	1.8	1.8	6.9
Other	b	-0.2	b	0.2	0.4	0.5
Total	-0.9	-3.2	-1.0	-2.9	-3.3	-11.4
Reagan Administration's Budget as Estimated by CBO	-62.3	-67.4	-69.2	-74.7	-78.9	

SOURCE: Congressional Budget Office.

a. Portions of the proposed power marketing reforms are included in the "Entitlements and Other Mandatory Spending" category.

b. Less than $50 million.

Government Enterprises. The budget would establish fees on new loans issued by Sallie Mae, Freddie Mac, Fannie Mae, and Connie Lee. These fees would yield less than $0.1 billion in 1990, but would result in $2.6 billion in receipts over the 1990-1994 period.

Arctic National Wildlife Refuge. The Reagan Administration proposes opening the refuge to oil and gas development, with no trading of lands with native corporations and no sharing of receipts with Alaska. CBO estimates receipts of $1.6 billion in 1991 for the first leases, while the President's budget projects initial lease sales of $2.1 billion in 1990. Additional receipts of $1 billion are projected for lease sales in 1993.

Power Marketing Reforms. The budget would raise interest rates and speed up repayments to the Treasury by federal power marketing administrations (PMAs). These changes would increase the price of federally generated hydropower, and would increase offsetting receipts by $1.5 billion over the 1990-1994 period, with nearly all of the increase coming after 1990. The Administration assumes that the necessary rate increases would be fully implemented in 1990 instead of 1991, as assumed by CBO. The proposed reforms would also reduce outlays in the "Entitlements and Other Mandatory Spending" category, which includes some of the power marketing receipts.

Uranium Enrichment. The budget proposes transferring the Department of Energy's enrichment operations to a new government corporation. Federal receipts for enrichment services would probably not change significantly in the near term, but this proposal would reclassify the receipts as offsetting collections to the corporation. As a result, they would be treated as a net reduction in discretionary spending instead of as offsetting receipts.

Other. Several other proposals in the Reagan Administration's budget would affect offsetting receipts. Taken together, all other changes would result in a net five-year decrease in offsetting receipts of about $0.5 billion. The budget includes higher receipts from the Postal Service for retirement costs, an increase in Coast Guard user fees, an increase in fees for veterans' medical care, and increased receipts from timber harvested on federal lands for export. The budget also assumes additional receipts from bonus bids on the Outer Continental Shelf for certain 1990 lease sales that are not included in the baseline. These increases are more than offset by a number of technical or categorization changes, including a proposed change to shift the classification of some U.S. Customs fees from offsetting receipts to revenues.

ASSET SALES AND PREPAYMENTS

The President's budget for 1990 proposes to continue the policies of selling loan assets, encouraging prepayments, and privatizing federal commercial activities through real asset sales. These transactions are proposed principally to achieve operating efficiencies, management improvements, and programmatic goals. They cannot be counted toward meeting the Balanced Budget Act deficit targets.

CBO estimates that a total of $4.4 billion in receipts will be generated from the sale of loan and real assets in 1990. Loan asset sales and prepayments would account for $3.3 billion of this total, with the remaining $1.1 billion coming from sales of other assets. Table III-7 lists the programs selected for sales during the 1990-1994 projection period.

Loan Asset Sales

The Reagan Administration is proposing to terminate three direct loan programs and sell their portfolios of loans. It is once again proposing to replace the Rural Housing Insurance Fund's mortgage loan program for single-family rural homes with 20,000 housing vouchers in 1990. As the direct loan program is terminated, the Administration proposes to sell newly originated loans and the remaining loan portfolio. Proceeds from the sale are estimated to total $1.7 billion in 1990. Similarly, the Administration is proposing to replace subsidized direct loans to develop housing for the elderly or handicapped with credit vouchers for project sponsors and to sell the remaining portfolio of loans. CBO estimates that this sale would yield proceeds of $500 million in 1990, $600 million in 1991, and $500 million in 1992. Finally, President Reagan proposes to sell SBA disaster and business loans during the 1990-1994 period, with estimated proceeds totaling $437 million.

The budget proposes legislation to permit the sale of loans from the Department of Education's College Housing and Higher Education Facilities loan portfolios. CBO estimates that the sales will yield $266 million in receipts in 1990. Other sales being proposed in the 1990 budget include loans from the Rural Development Insurance Fund and the Health Maintenance Organizations and Medical Facilities

TABLE III-7. REAGAN ADMINISTRATION'S PROPOSALS--
ASSET SALES AND PREPAYMENTS
(By fiscal year, outlays in billions of dollars)

Proposed Changes	1990	1991	1992	1993	1994	Cumulative Five-Year Changes
Loan Asset Sales						
Rural housing	-1.7	0.1	0.1	0.1	0.1	-1.3
Housing for elderly and handicapped	-0.5	-0.6	-0.5	0.2	0.2	-1.2
Small Business Administration	-0.2	-0.1	-0.1	a	-0.1	-0.4
College housing and facilities	-0.3	a	a	a	a	-0.2
Other	-0.2	-0.1	-0.1	a	a	-0.3
Subtotal	-2.8	-0.6	-0.5	0.2	0.2	-3.4
Prepayments						
Rural Electrification Administration and Rural Telephone Bank	-0.5	-0.1	-0.3	a	a	-0.9
Other Asset Sales						
Naval petroleum reserves	-1.0	0.4	0.4	0.4	0.4	0.5
Power marketing administrations	-0.1	-1.2	0.1	0.1	0.1	-1.0
Other	a	0	0	0	0	a
Subtotal	-1.1	-0.8	0.5	0.5	0.5	-0.5
Total	-4.4	-1.5	-0.3	0.7	0.7	-4.8

SOURCE: Congressional Budget Office.

a. Less than $50 million.

loans. CBO estimates that receipts from these sales would total $300 million over the next five years.

Loan Prepayments

The Reagan Administration's proposals to offer incentives to borrowers from the Rural Electrification Administration (REA) and the Rural Telephone Bank to prepay their loans would yield an estimated $500 million in 1990 and $900 million through 1994. To encourage electric cooperatives to increase the use of private loans rather than subsidized federal loans, the President proposes that REA borrowers whose loans were financed by the Federal Financing Bank be afforded an opportunity to prepay their loans without the usual premium. Borrowers who agree not to seek further financial assistance from the REA can refinance their loans using an 80 percent federal guarantee.

Other Asset Sales

The Administration's proposals to sell other assets would yield $1.1 billion in 1990, mostly from selling the naval petroleum reserves at Elk Hills, California, and Teapot Dome, Wyoming. Terms of the sale would include a cash payment and a contract to supply 50,000 barrels of oil per day for the Strategic Petroleum Reserve (SPR) from 1990 through 1995 and 10 million barrels for a Defense Petroleum Inventory. That is, the buyer would be bidding on the rights to these oil fields and the obligation to supply oil to the SPR and the defense inventory at no additional cost to the government. The estimated cash price is $1 billion plus an entitlement to 119.5 million barrels of oil from this sale.

For the fourth consecutive year, the Administration proposes to sell assets of both the Alaska Power Administration and the Southeastern Power Administration in 1990. CBO estimates, however, that only the Alaska PMA will be sold in 1990 and that proceeds from its sale to local utilities and the State of Alaska would be $75 million. The Southeastern PMA, including the exclusive rights to market power from federal hydro plants, would be sold for an estimated $1.2 billion; the Administration estimates that the proceeds would be realized in 1990, but CBO believes that the sale cannot be completed until 1991.

NET INTEREST

Outlays for net interest are not directly controllable, but they depend on the size of the government's deficit and on market interest rates. The spending and revenue changes proposed in President Reagan's budget, if enacted, would substantially reduce the government's borrowing needs. As Table III-8 shows, the associated savings in interest costs mount rapidly from $1 billion in 1990 to $15 billion in 1994.

As these savings imply, the President's proposals would significantly curb the growth in the federal debt. Even if fully adopted, the President's proposals would not eliminate the deficit, and the government's debt would continue to climb. CBO estimates that the President's budget proposals would lead to almost $2.7 trillion in publicly

TABLE III-8. REAGAN ADMINISTRATION'S PROPOSALS-- NET INTEREST (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	Cumulative Five-Year Changes
CBO Baseline	182.1	193.1	198.5	204.0	207.7	
Proposed Changes						
Debt service savings	-1.0	-3.7	-7.1	-10.9	-15.1	-37.8
Other interest	0.1	0.6	0.7	1.0	1.4	3.7
Total	-0.9	-3.2	-6.4	-9.9	-13.7	-34.1
Reagan Administration's Budget as Estimated by CBO	181.2	189.9	192.1	194.2	194.0	

SOURCE: Congressional Budget Office.

held debt at the end of 1994--about one-third higher than today's level, but more than $200 billion below the debt that would be generated if current policies remain unchanged.

While net interest primarily represents the government's cost of financing its debt, a variety of other interest payments and collections are also included. In particular, this category of spending reflects interest income collected by the government from loans or similar transactions. The President proposes to curtail many federal lending programs and to sell part of the government's loan portfolio. As a result, the government's interest income would shrink. The interest lost under these proposals amounts to about $0.1 billion in 1990 and $1.4 billion in 1994 (see Table III-8).

Outlays for net interest soared in the early and mid-1980s, as a consequence of large deficits and high interest rates, but are expected to climb much less rapidly in the next six years. With the deficit reductions proposed in the Reagan Administration's budget, net interest outlays--in CBO's estimate--would be essentially flat after 1991. While CBO projects that such spending will taper off, however, its assumptions are much less optimistic than the Administration's. The enormous differences resulting from CBO's and OMB's contrasting forecasts for interest rates were summarized in Chapter II, and the comparatively small differences that stem from technical assumptions are discussed briefly in Chapter IV.

CHAPTER IV

CBO TECHNICAL REESTIMATES

A vast array of factors influences federal government revenues and outlays, and budget projections must incorporate assumptions about these factors. As Chapter II pointed out, some of the key assumptions concern real growth, inflation, interest rates, and other aspects of the economy's performance. Differing economic assumptions account for a large and widening gap between Administration and Congressional Budget Office (CBO) deficit projections. But these economic differences tell only part of the story. Particularly in 1990--the current focus of attention for policymakers--CBO believes that the Reagan Administration's estimates substantially understate the likely deficit for reasons unrelated to the economic forecast. This chapter briefly examines these sources of disagreement, which are termed technical reestimates. Outlays dominate the technical reestimates in all years and are discussed first, followed by a short section on revenues.

TECHNICAL REESTIMATES OF OUTLAYS

Only rarely does the federal government have complete control over outlays. Apart from economic performance, many factors affect actual spending. Technical differences in estimates often stem from different assumptions about caseloads and other factors that drive spending for entitlement and mandatory programs (such as benefit programs, farm price supports, and deposit insurance). For some programs--termed defense and nondefense discretionary programs--the Congress explicitly enacts new levels of spending authority each year. Actual outlays, however, are subject to vagaries in how quickly agencies spend money, variability in loan demand, and so forth. And brand-new initiatives--such as the proposed sale of government assets--are especially uncertain in both their timing and their dollar impacts.

CBO's technical reestimates of the Reagan budget outlays are large and positive in all years, especially in 1990. Leading the list is deposit insurance, denoting the outlays of the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC). CBO's estimates of deposit insurance spending greatly exceed those of the Administration, contributing over half of the total sum of technical reestimates for 1990 and representing the single biggest item in all other years as well. CBO's reestimates of deposit insurance spending, and other major reestimates, are shown in Table IV-1.

TABLE IV-1. CBO TECHNICAL REESTIMATES OF PRESIDENT REAGAN'S BUDGET (By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993	1994
Outlays						
Deposit insurance	5	11	8	6	6	6
Asset sales	a	1	1	1	1	1
Federal Communications Commission auction receipts	0	2	1	0	0	0
Leasing of Arctic National Wildlife Refuge	0	2	-2	0	a	0
Repayment reform (power marketing administrations)	0	1	a	a	a	a
Defense	-2	3	4	4	4	6
Medicaid and Medicare	a	1	1	-1	2	6
Income security	a	2	3	2	3	3
Social Security	a	a	-1	-1	-2	-4
Commodity Credit Corporation	-1	-1	-1	-1	-1	a
Net interest						
Debt service	a	a	1	1	1	1
Other	-1	-1	1	1	2	2
All other outlays	-1	-1	-5	-3	-4	-2
Total Outlays	2	21	11	9	12	20
Revenues	-1	4	2	1	6	11
Deficit	2	17	9	8	5	9

SOURCE: Congressional Budget Office.

a. Less than $500 million.

Deposit Insurance

The Reagan Administration's estimates incorporate an abrupt dip in spending for deposit insurance in 1990. In the Administration's view, total outlays for deposit insurance will exceed $12 billion in 1989 but plummet to less than $1 billion in 1990. CBO, in contrast, projects a far smaller drop in outlays from this year's peak levels as both funds, especially the FSLIC, continue to address their caseloads aggressively. The FDIC fund currently has ample resources on hand to fund outlays of $1 billion to $1.5 billion a year after 1989, the levels anticipated by CBO. The FSLIC fund, in contrast, has a near-zero balance; however, FSLIC is expected to continue using a variety of techniques, including promissory notes and borrowing from the Federal Home Loan Bank System, to maintain high levels of assistance. Thus, both funds are expected to spend large sums by historical standards throughout the projection period. Although the Administration is reported to be working on possible solutions to the problems posed by insolvent savings and loan institutions, President Reagan's 1990 budget did not incorporate any proposals. In the absence of explicit proposals, CBO's estimates of spending for deposit insurance appear more consistent with the FDIC's and FSLIC's recent and planned actions.

Asset Sales and Other Major Initiatives

CBO estimates that several specific initiatives proposed in the budget are unlikely to reduce the deficit as much as the Reagan Administration claims. These initiatives include the sale of government assets, the auction by the Federal Communications Commission (FCC) of licenses to portions of the electromagnetic spectrum, the opening of the Arctic National Wildlife Refuge (ANWR) to oil exploitation, and tightening of repayment requirements for the power marketing administrations (see Table IV-1).

Asset Sales. The Reagan Administration envisions selling both physical and financial assets of the federal government. CBO's reestimates largely reflect more modest expectations about sales of physical assets, principally two of the power marketing administrations (PMAs). The Administration's budget includes more than $1 billion in 1990 from selling the Alaska and the Southeastern PMAs. The Reagan Administration also includes $1 billion or more in receipts annually in

1991 through 1994 from selling other power marketing administrations, though it neither identifies those to be sold nor shows any of the associated budgetary effects. CBO agrees that the government could probably complete the sale of the Alaska Power Administration in 1990, receiving about $75 million, but believes that the sale of the Southeastern Power Administration is unlikely to be consummated until 1991. CBO includes no proceeds from subsequent sales because of the absence of detail in the Administration's proposal. President Reagan's budget also projects an extra $125 million to $150 million a year from a reinvigorated program to identify and sell surplus physical property belonging to the federal government, a projection that CBO believes unrealistic. CBO's estimates of proceeds from the sale or prepayment of loans are slightly different from those of the Reagan Administration.

FCC Auction Receipts. The Administration's own budget includes about $2 billion in 1990 and $1 billion in 1991 from auctioning licenses to use part of the unassigned radio spectrum for purposes such as cellular telephones. CBO's reestimate is predicated on the likely availability of fewer frequencies (4 megahertz, in contrast to the 6 assumed by the Administration) and smaller receipts (approximately $125 million per megahertz versus the $563 million per megahertz assumed by the Administration). Thus, in CBO's view, this proposal would be more likely to yield about $500 million over the two years. The Administration similarly envisioned receipts of only about one-half billion dollars when it first proposed the FCC auctions in the 1989 budget.

Arctic National Wildlife Refuge. The proposal to open the ANWR to minerals exploitation would, in the Administration's view, generate about $2 billion in 1990. The Department of the Interior, however, would need 21 to 24 months to prepare for the first lease sale after the necessary legislation is passed. In analyzing this proposal, CBO assumes that any such legislation would not be enacted until late in fiscal year 1989 at the earliest. Furthermore, CBO has a smaller estimate of the value of ANWR leases to oil companies, which would have to pay continuing royalties as well as an initial bonus bid. CBO thus estimates that President Reagan's proposal would generate no receipts from bonus bids in 1990 and about $1.6 billion in 1991.

PMA Repayment Reform. Besides selling two of the power marketing administrations, the Administration proposes reforming repayment requirements for the remaining PMAs (principally the Bonneville Power Administration). The PMAs have used federal monies in the past to finance their capital programs. As discussed in Chapter III, the Administration's proposal entails increasing the interest rate charged to the PMAs and setting fixed schedules for principal repayments. President Reagan's budget includes about $1 billion a year in 1990 through 1994 from these reforms. The PMAs would have to charge higher rates to their customers in order to obtain the necessary funds. CBO estimates that such increases could not take effect quickly enough to reduce the deficit significantly in 1990, although CBO substantially concurs with the Administration's estimated savings in later years.

Defense

CBO's estimates of defense spending, assuming adoption of President Reagan's budget authority request, exceed Office of Management and Budget (OMB) projections by $3 billion to $6 billion a year after 1989, or about 1 percent to 2 percent of total outlays. Based on the historical relationship between budget authority and outlays, CBO projects higher spending for operation and maintenance and procurement, partly mitigated by lower spending for research, development, testing, and evaluation. CBO also projects higher net outlays for the defense revolving funds than does the Administration.

Medicaid and Medicare

CBO's estimates of spending in the fast-growing Medicaid program exceed the Administration's by $500 million to $2 billion a year in 1990 through 1994. Similarly, CBO projects higher Medicare spending in most years, with greater Hospital Insurance outlays and smaller premium collections more than offsetting less rapid growth in Supplementary Medical Insurance benefits. The CBO and OMB Medicare estimates, however, continue to reflect a lingering disagreement over the costs of the new prescription drug benefits enacted in last year's program expansions. CBO's estimates of drug benefits are $600 million shy of the Administration's in 1991, and almost $2 billion lower in 1992. The Administration, in contrast, foresees rapid depletion of the Catastrophic Drug Insurance Trust Fund and sharp increases in the deductible in the later years.

Income Security and Social Security

CBO estimates higher outlays than does the Administration for a variety of income security programs--notably Civil Service Retirement, subsidized housing, family assistance payments, the refundable portion of the earned income tax credit, and Supplemental Security Income. All told, these reestimates add $2 billion to $3 billion a year to outlays (see Table IV-1). CBO's estimates of Social Security benefits, however, are smaller than the Administration's after 1990. Because it uses more recent data on the number of beneficiaries, and assumes slightly slower growth in the eligible population, CBO foresees somewhat fewer beneficiaries than does the Administration--a difference of 50,000 recipients in 1989 and more than 300,000 by 1994. Furthermore, the key differences are concentrated in categories of recipients who tend to collect relatively high benefits. Although large in total, the technical differences represent a small proportion of Social Security outlays.

Other Technical Reestimates

CBO projects lower outlays than the Administration for the Commodity Credit Corporation (CCC), with the difference amounting to about $1 billion a year. The chief reason is the contrasting treatment of working capital. The Administration estimates include $1 billion a year for this category. Working capital, however, is essentially a residual category, representing--in historical spending data--those outlays that the CCC could not accurately ascribe to specific commodities. Sometimes positive, sometimes negative, it has historically averaged close to zero, and CBO therefore does not include it in the estimates.

Technical reestimates of net interest reflect extra debt service costs traceable to other reestimates of revenues and outlays. Additional reestimates--small as a share of net interest spending--primarily reflect different assumptions about Treasury financing practices, lending activity, and intrabudgetary transactions (some of which were treated inconsistently in the Reagan Administration's original estimates).

In the aggregate, all other technical reestimates of outlays are quite small in 1989 and 1990, although they reduce total outlays by as much as $5 billion in subsequent years. CBO projects lower outlays for a wide variety of activities. These programs include the Rural Housing Insurance Fund, the Federal Housing Administration fund, the Postal Service, several veterans' programs, general government, and Outer Continental Shelf receipts, among others. These reestimates more than outweigh a few upward revisions. In 1990 and beyond, about $600 million of the reestimates simply reflect reclassification of some customs user fees and Nuclear Regulatory Commission fees, which are treated as revenues by the Administration. Reclassifying these as offsetting receipts does not affect the deficit.

TECHNICAL REESTIMATES OF REVENUES

Technical reestimates of the Reagan Administration's projected budget revenues reflect information and assumptions about taxpayers' behavior, patterns and timing of tax collections, effective tax rates, the distribution of income and deductions, and numerous other factors not directly ascribable to contrasting economic assumptions about aggregate incomes. As Table IV-1 shows, technical reestimates of revenues are relatively small for 1989 through 1992, and somewhat larger for 1993 and 1994. Reestimates raise revenues in all years after 1989, by sums ranging from $1 billion to $11 billion each year, and amounting to $4 billion in 1990.

The bulk of the reestimates stem from differing projections of baseline, or "current services," receipts. CBO has reestimated the Reagan Administration's revenue proposals for technical reasons by less than $500 million in 1990, and by $800 million to $1 billion each year thereafter.

The reestimates of personal and corporate income taxes are positive for each year beginning in 1990. In 1990, virtually all of the $4 billion difference lies in the individual income tax. Reestimates of other tax sources are about one-half billion dollars or less and offset one another. By 1994, reestimates of the two income taxes total $15 billion, but are partially offset by differences in assumptions about employers' contributions for unemployment insurance and about the composition of the Federal Reserve's portfolio.

The upward changes in the individual income tax estimates reflect contrasting assumptions about the effects of tax rate reductions and certain base-broadening provisions of tax reform. On the corporate side, CBO assumes that the effective tax rate remains stable in the longer term, while the Administration assumes some decline.

Estimates of unemployment insurance (UI) taxes diverge during the later years of the projection period, as CBO projects that fiscally sound UI trust funds will enable some state governments to lower their tax rates. Because this effect cumulates over time, it reduces expected revenues relative to the Reagan Administration's estimates by small amounts in the early years of the projection period, but the gap grows to $2 billion by 1994.

The only other significant technical reestimate arises in estimates of the Federal Reserve System's earnings, which CBO expects to be slightly higher than does the Administration in 1990, but lower by growing amounts thereafter. Based on its interpretation of recent historical data, CBO projects shorter average holding periods for securities. In a period of declining interest rates, regardless of their levels, shorter holding periods and faster turnover mean that lower-earning instruments account for a greater share of the Federal Reserve's portfolio. In 1990, this effect is small and is overridden by CBO's inclusion of gains from revaluation of the system's foreign currency holdings. By 1994, CBO assumptions reduce the Administration's projections of Federal Reserve earnings by $2 billion.

CBO's reestimates of the Reagan Administration's revenue proposals are quite small, and stem mostly from disagreement between CBO and OMB about the proper budget classification of several fees. About three-quarters of the difference in 1990 and over half the difference in 1994 arise because CBO classifies Nuclear Regulatory Commission fees and certain customs user fees as offsetting receipts--that is, as negative outlays. Since the Administration counts these fees as revenues (both the amounts in current law as well as the proposed increases), CBO shows negative revenue reestimates. Because these fees are included in CBO's outlay estimates of the proposed budget, reclassifying them does not affect the deficit. Other revisions in estimated proposals are minor.

APPENDIXES

APPENDIX A

BASELINE BUDGET PROJECTIONS

Throughout this report, the new initiatives and priorities recommended by President Reagan are measured against the comparable estimates in the Congressional Budget Office budget baseline, which assumes the continuation of current revenue and spending policies. This appendix describes the CBO baseline, explains recent baseline revisions, and examines several conceptual differences between the CBO and Administration baselines.

The CBO baseline budget projections are summarized in Table A-1. The revenue and spending estimates are consistent with the economic assumptions described in Chapter II. For revenues, and for entitlement programs such as Social Security, the CBO baseline projects according to current laws. Spending programs whose authority is provided in annual appropriations acts--including defense activities and many nondefense programs, such as housing assistance, space, and transportation--are projected to maintain constant levels adjusted for inflation. Estimates of offsetting receipts are consistent with current laws and policies, and net interest projections reflect the assumed interest rates and deficits.

REVISIONS TO THE CBO BASELINE

In January 1989, CBO published its initial baseline budget projections for 1990 through 1994. With more recent information and the release of President Reagan's budget, CBO has prepared revised spending projections. No change has been made in CBO's revenue projections. Estimates of federal outlays have increased by an average of $6 billion per year. The baseline deficit is now projected to be $159 billion in 1989, declining to $146 billion in 1990 and $130 billion in 1994.

TABLE A-1. BASELINE BUDGET PROJECTIONS (By fiscal year)

	1989	1990	1991	1992	1993	1994
In Billions of Dollars						
Revenues						
Individual income	433	481	520	558	596	636
Corporate income	103	112	120	125	129	136
Social insurance	365	391	417	441	468	497
Other	82	85	84	85	87	90
Total	983	1,069	1,140	1,209	1,280	1,359
Outlays						
National defense	297	303	314	326	339	352
Nondefense discretionary spending	188	206	210	218	225	234
Entitlements and other mandatory spending	548	585	633	673	720	770
Net interest	169	182	193	199	204	208
Offsetting receipts	-60	-61	-64	-68	-72	-76
Total	1,142	1,215	1,287	1,348	1,416	1,489
Deficit	159	146	146	140	135	130
Deficit Targets	136	100	64	28	0	a
Debt Held by the Public	2,194	2,340	2,485	2,624	2,758	2,888
As Percentages of GNP						
Revenues						
Individual income	8.4	8.8	8.9	9.0	9.0	9.1
Corporate income	2.0	2.1	2.1	2.0	2.0	1.9
Social insurance	7.1	7.2	7.2	7.1	7.1	7.1
Other	1.6	1.6	1.4	1.4	1.3	1.3
Total	19.2	19.6	19.6	19.5	19.5	19.4
Outlays						
National defense	5.8	5.6	5.4	5.3	5.1	5.0
Nondefense discretionary spending	3.7	3.8	3.6	3.5	3.4	3.3
Entitlements and other mandatory spending	10.7	10.7	10.9	10.9	10.9	11.0
Net interest	3.3	3.3	3.3	3.2	3.1	3.0
Offsetting receipts	-1.2	-1.1	-1.1	-1.1	-1.1	-1.1
Total	22.3	22.3	22.1	21.8	21.5	21.2
Deficit	3.1	2.7	2.5	2.3	2.1	1.9
Debt Held by the Public	42.8	42.9	42.8	42.4	41.9	41.2

SOURCE: Congressional Budget Office.

NOTE: The projections include Social Security, which is off-budget.

a. The Balanced Budget and Emergency Deficit Control Reaffirmation Act of 1987 established targets for 1988 through 1993.

Spending estimates for Federal Savings and Loan Insurance Corporation (FSLIC) deposit insurance have been increased by roughly $2 billion each year (see Table A-2). Estimated 1989 outlays have been increased by $1 billion to reflect higher costs from thrift sales in December 1988. The rest of the revisions reflect a change in the budgetary accounting of certain obligations that FSLIC may incur in assisting troubled thrift institutions. When an insolvent institution is acquired, FSLIC may promise to pay the buyer the difference between the market value and the book value of certain covered assets. CBO's

TABLE A-2. REVISIONS TO CBO'S JANUARY 1989 BASELINE
(By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993	1994
			Outlays			
January Baseline	1,138	1,209	1,280	1,344	1,410	1,480
Changes:						
Deposit Insurance	2	1	2	2	2	3
Agriculture	a	2	1	1	a	a
Subsidized Housing	a	1	1	1	1	1
Veterans' Compensation and Pensions	1	-1	a	a	a	a
Outer Continental Shelf Rents and Royalties	a	1	a	a	a	a
Net Interest	a	a	1	1	1	1
Other	1	1	1	a	1	3
Total Changes	4	5	6	5	6	8
Revised Baseline	1,142	1,215	1,287	1,348	1,416	1,489
			Deficit			
January Baseline	155	141	140	135	129	122
Changes	4	5	6	5	6	8
Revised Baseline	159	146	146	140	135	130

SOURCE: Congressional Budget Office.

a. Less than $0.5 billion.

previous baseline did not record a budget outlay until a cash outlay was expected--as long as 10 years after a commitment was made. The revised baseline records a budget outlay at the time the acquiring institution sells the assets, when the extent of FSLIC's obligation becomes known. This change in accounting has been made to conform with the treatment of FSLIC promissory notes, which are viewed as a form of federal agency borrowing.

Estimates of spending for agriculture are now higher by nearly $2 billion in fiscal year 1990 and $1 billion in 1991 and 1992. Most of this increase is the result of increased outlays for the Commodity Credit Corporation's (CCC) corn program. In January 1989, the Department of Agriculture boosted its estimate of the corn inventory left after last year's drought. The increased supply of corn lowers CBO's projections for corn prices, widens the gap between the market price and the CCC target price for corn, and leads to higher CCC price support payments. In addition, spending for agriculture in the baseline has been increased to reflect spending by the Farm Credit System Financial Assistance Corporation. This entity was classified as off-budget in CBO's previous baseline; the revised baseline, however, classifies it as on-budget, following the Administration's interpretation of a provision of the 1989 Rural Development, Agriculture, and Related Agencies Appropriations Act.

Spending for subsidized housing is higher in all years, reflecting a larger number of covered units and the announcement of an increase in rental payments to owners of assisted units. Spending for veterans' compensation and pensions is higher in 1989 and lower in 1990; the checks for October 1, 1989--which falls on a weekend--will be paid from 1990 funds, as previously expected, but the transfer of funds will be split between the 1989 and 1990 fiscal years. Because CBO has reduced its estimate of royalty payments made by leaseholders, and has removed from the baseline a 1990 lease sale not included in the Administration's current services projections, royalty and bonus receipts from oil leases on the Outer Continental Shelf are now projected to be lower in all years of the projection period. Net interest payments are higher in all years, since the revisions in outlays add directly to the estimated deficits and increase federal borrowing needs. Other revisions affect a wide variety of spending programs, but they are small in the aggregate.

CONCEPTUAL DIFFERENCES WITH THE REAGAN ADMINISTRATION'S BASELINE

The CBO baseline follows the specifications laid down in the Balanced Budget Act. In the budget documents, the Office of Management and Budget (OMB) also publishes its own estimate of the Balanced Budget Act baseline for 1990. The CBO baseline deficit estimate of $146 billion exceeds the OMB baseline deficit estimate of $126 billion primarily because of the differing economic and technical estimating assumptions described in this volume. In three instances, however, CBO and OMB differ in their interpretation of the Balanced Budget Act rules for constructing the baseline.

Military Retirement Accrual Charges

The Department of Defense makes payments to the Military Retirement Trust Fund to cover the benefit costs for current active-duty and reserve personnel as they accrue. These payments for accrual charges are shown as outlays from the military personnel appropriations in the national defense function of the budget. Because payments to federal trust funds are intragovernmental, a corresponding offset is recorded in the Military Retirement Trust Fund in the undistributed offsetting receipts function. The actuaries of the Department of Defense have recently updated their long-run economic and demographic assumptions and have reduced the rate of accrued military retirement charges starting in 1990. This change in accrual charges should reduce defense discretionary outlays and offsetting receipts by equal amounts, but should have no effect on the baseline deficit.

The specifications for the budget baseline in section 251(a)(6) of the Balanced Budget Act provide that discretionary appropriations be "increased to cover the increased costs to agencies of personnel benefits (other than pay) required by law." If interpreted narrowly, this provision would allow appropriations for military personnel to be adjusted for an increase in retirement costs but not, as in the present instance, for a decrease in retirement costs. As a result, the baseline payments to the Military Retirement Trust Fund would exceed the baseline receipts to the fund, which according to the Balanced Budget Act must reflect the best estimate of funding requirements under current law. This inconsistency would cause total outlays and the deficit to be overstated.

When two provisions of a law give conflicting instructions, the sections may be reconciled to avoid anomalous results. In this instance, CBO has interpreted the rule governing the projection of discretionary appropriations broadly to allow adjustments for decreases as well as increases in the costs of personnel benefits. This interpretation reflects Congressional policy to adjust for changes in personnel benefits, yet allows outlays for military personnel to be consistent with the receipts to the Military Retirement Trust Fund. OMB has not adjusted the military personnel appropriations for the decrease in military retirement charges. The OMB approach causes the payments to the Military Retirement Trust Fund to exceed the receipts and adds $2.8 billion to the baseline deficit in 1990.

Pay Absorption

The Balanced Budget Act provides that, in computing the baseline for discretionary appropriations, the previous year's appropriation is inflated and is "adjusted to reflect the full 12-month costs (without absorption) of the pay adjustment that occurred in such [previous] fiscal year." CBO assumes that, in accordance with the Administration's 1989 budget request, the 1989 domestic appropriations provided no money to fund the 4.1 percent pay raise that took effect in January 1989. That is, CBO assumes that the cost of the 1989 pay raise for employees of civilian agencies was fully absorbed. Similarly, CBO assumes that 40 percent of the cost of the pay raise for civilian defense employees and 7 percent of the cost of the pay raise for military personnel was absorbed in 1989. In accordance with the Balanced Budget Act, CBO increases the 1990 baseline appropriations to provide enough money to cover the part of the 1989 pay raise that was not funded in 1989. OMB, in contrast, assumes that the 1989 pay raise was fully funded and that no pay absorption took place. This assumption reduces OMB's 1990 defense outlays by $0.5 billion and nondefense discretionary outlays by $1.5 billion compared with CBO.

Advance Deficiency Payments

According to the Balanced Budget Act, the baseline projections for farm price supports must assume that "unless otherwise required by law, advance deficiency payments . . . under the Agricultural Act of 1949 will be made in accordance with applicable regulations and payment rates for 1987." Under the Food Security Act of 1985, as amended by the Omnibus Budget Reconciliation Act of 1987, the Secretary of Agriculture must make between 40 percent and 50 percent of deficiency payments before the crops are harvested and sold. Because 40 percent of deficiency payments were made in advance in 1987, the CBO baseline assumes that 40 percent of deficiency payments will be made in advance for all crop years. OMB assumes that 50 percent of deficiency payments will be made in advance in 1989, and 40 percent in 1990. The higher 1989 proportion accelerates payments that would otherwise be made in 1990, and reduces OMB's outlays and the baseline deficit for that year by $0.8 billion.

APPENDIX B

MAJOR CONTRIBUTORS

The following analysts prepared the revenue and spending projections in this report:

Revenue Projections

Mark Booth	Corporate income taxes, Federal Reserve System earnings
Maureen Griffin	Social insurance contributions
Richard Kasten	Individual income taxes
Eric Nicholson	Excise taxes
Kathleen O'Connell	Individual income taxes, estate and gift taxes
Marianne Page	Customs duties, miscellaneous receipts
Linda Radey	Social insurance contributions, excise taxes
Frank Sammartino	Individual income taxes

Spending Projections

Defense and International Affairs

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Kent Christensen	International Affairs
Raymond Hall	Defense
Barbara Hollinshead	Defense
William Myers	Defense
Amy Plapp	Defense
Joseph Whitehill	International Affairs
Ben Wolters	Defense

Spending Projections (continued)

Human Resources

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Richard Curley	Supplemental Security Income, veterans' education
Cathy Ellman	Foreign Service Retirement
Alan Fairbank	Hospital Insurance
Holly Harvey	Supplementary Medical Insurance
Lori Housman	Public Health Service
Deborah Kalcevic	Education
Jean Kayser	Health programs
Julia Isaacs	Food Stamps, child nutrition
Donald Muse	Medicaid, Medicare
Michael Namian	Social services
Janice Peskin	Aid to Families with Dependent Children, child support enforcement
Michael Pogue	Unemployment Insurance, training programs, Civil Service Retirement
Kathleen Shepherd	Veterans' benefits

Natural and Physical Resources

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Peter Fontaine	Energy
Theresa Gullo	Water resources, conservation, and land management
James Hearn	General government, Agricultural Credit Insurance Fund, Outer Continental Shelf receipts
Hsin-Hui Hsu	Agriculture
Mary Maginniss	Deposit insurance
Eileen Manfredi	Agriculture

Spending Projections (continued)

Natural and Physical Resources (continued)

Marjorie Miller	Transportation, Federal Housing Administration
Marta Morgan	Community and regional development, general government
Andrew Morton	Agriculture
Deborah Reis	Recreation, pollution control, water transportation
Mitchell Rosenfeld	Air transportation, justice, Postal Service
Brent Shipp	Housing and mortgage credit
Michael Sieverts	Science and space, justice, other natural resources

Other

Janet Airis	Appropriation bills
Edward Blau	Appropriation bills
Paul Christy	Other interest
David Elkes	National Income and Product Accounts
Betty Embrey	Appropriation bills
Kenneth Farris	Computer support
Danila Girerd	Credit budget, asset sales
Glen Goodnow	Authorization bills
Vernon Hammett	Computer support
Sandra Hoffman	Computer support
Richard Krop	Civilian agency pay
Fritz Maier	Computer support
Rodney Rasmussen	Budget projections
Kathy Ruffing	Treasury borrowing, interest, and debt
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